FASAB

FEDERAL ACCOUNTING
STANDARDS ADVISORY BOARD

FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended

as of June 30, 2021

SFFAC 1-9
SFFAS 1-59
Interpretations 1-10
Technical Bulletins
Technical Releases 1-19
Staff Implementation Guidance

Contents

Statement of Federal Financial Accounting Standards

Interpretations

Technical Bulletins

Technical Releases

Staff Implementation Guidances

Appendices

Foreword

The *FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended ("FASAB Handbook")* contains the body of accounting concepts and standards for the U.S. government.[1] Specifically, the *FASAB Handbook* incorporates the following documents published through June 30, 2021, with the exception of SFFAS 59, which was issued on July 30, 2021.

- Statements of Federal Financial Accounting Concepts 1-9,
- Statements of Federal Financial Accounting Standards 1-59,
- Interpretations 1-10,
- Technical Bulletin 2000-1 through 2020-1,
- Technical Releases 1-19, and
- all Staff Implementation Guidance.

Please note that SFFAS 59 effective for reporting periods after September 30, 2021 transitions RSI presentation requirements, to include G-PP&E Land and permanent land rights de-recognition to disclosure requirements in 2026. As a result, this HandBook version only incorporates the RSI requirements effective for periods 2022-2025. Fiscal year 2026 disclosure requirements will be updated in subsequent HandBook version(s) as appropriate.

Origins of the Documents

The concepts, standards, interpretations, technical bulletins, technical releases, and staff implementation guidance presented in the *FASAB Handbook* were issued in accordance with policies and procedures approved by the Department of the Treasury (Treasury), the Office of Management and Budget (OMB), and the Government Accountability Office (GAO) at the time of their issuance. These three central agencies, referred to collectively as the "sponsors," established the Federal Accounting Standards Advisory Board (FASAB) in 1990. The mission of the FASAB is to serve the public interest by improving federal financial reporting through issuing federal financial accounting standards and providing guidance after considering the needs of external and internal users of federal financial information.[2]

[1]Versions of the *FASAB Handbook* issued prior to June 30, 2011, were referred to as *Pronouncements as Amended, Statements of Federal Financial Accounting Concepts and Standards* (2008-2010), *Original Pronouncements, Statements of Federal Financial Accounting Concepts and Standards* (2007), or *Volume I, Original Pronouncements, Statements of Federal Federal Financial Accounting Concepts and Standards* (2004-2006).

[2]Mission Statement, Federal Accounting Standards Advisory Board. For a more extensive description of FASAB's role, refer to Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, Paras. 23-29.

Concepts Statements

Statements on concepts differ from statements of accounting standards. Statements on concepts are more general than statements on standards and do not contain specific authoritative requirements for federal agencies. After approval by the Board, concepts statements provide general guidance to the Board itself as it deliberates on specific issues. They also are useful to the OMB in carrying out its statutory responsibilities, and others in understanding federal accounting and financial reports.

Standards

Using a due process and a consensus building approach, the Board promulgates accounting standards after considering the financial and budgetary information needs of Congress, executive agencies, other users of federal financial information, and comments from the public. The Memorandum of Understanding dated December 3, 2009, is included in Appendix C and describes the Board's authorities and processes.

Interpretations

Interpretations clarify original meaning, add definitions, and provide other guidance for existing SFFAS. They are narrow in scope. FASAB will respond to requests for guidance by providing technical assistance, including, in some cases, interpretations. When drafting an interpretation the FASAB staff submits the request to the Board and reviews applicable literature and consults with knowledgeable persons, as appropriate. FASAB will consider the draft interpretation at an open meeting. Proposed interpretations are exposed for public comment for at least 30 days. Interpretations approved by a majority of the Board and not objected to by a Board member representing a principal within 45 days are published by FASAB.

Technical Bulletins

Technical bulletins provide guidance for applying statements and interpretations and resolving issues not directly addressed by them. Technical bulletins are used when the nature of an issue does not warrant more extensive due process. They are generally in question and answer format.

Technical Releases

The Accounting and Auditing Policy Committee (AAPC) provides implementation guidance through technical releases that are reviewed and published by the FASAB.

Staff Implementation Guidance

The staff provides implementation guidance. Such guidance is issued if a majority of the Board does not object.

GAAP Documents

When adopted and issued, these documents become federal accounting standards and implementation guidance. It is expected that FASAB will continue to issue guidance through the documents described above. As new documents are adopted, the *FASAB Handbook* will be updated. Individual documents issued between updates are available through a variety of sources.

Purpose of the *FASAB Handbook*

The *FASAB Handbook* compiles and codifies the documents produced by the FASAB. It is designed to meet the needs of users for an authoritative reference to concepts, standards, interpretations, technical bulletins, technical releases, and other issuances. It contains extensive cross-referencing and indexing.

Organization of the *FASAB Handbook*

This volume presents each concepts statement, standards statement, interpretation, technical bulletin, technical release and staff implementation guide as a separate chapter (refered to as “statement”). The issue date and effective date of each statement are presented first. Next, any interpretations, technical bulletins, and technical releases that relate to the statement are identified. A summary precedes presentation of each statement.

In some cases the statements have been affected by later statements or affect earlier statements. References are provided on the title page of each statement to direct the reader to the affected paragraphs and indicate the source and nature of the change. Within the text of the statements, ellipses alert the reader that provisions have been deleted as a result of other statements. Original provisions modified or affected by a subsequent statement but not deleted are modified in the text. New provisions added by a subsequent statement are inserted in the original statements. When paragraphs are inserted they are numbered with the number of the preceding paragraph followed by a capital letter (5A). When footnotes are inserted, they are numbered with number of the previous footnote followed by a lower case letter (1a). The reader can review the basis for conclusions of the amending statement for the rationale for the change.

Some statements contain illustrations. These illustrations are general in nature and may not apply to specific cases that appear similar but have unique circumstances. For specific cases, the objective should be to arrive at the specific answer that applies the body of accounting standards in that specific case.

The glossaries originally published with each statement have been codified in a single glossary Appendix E.

The *FASAB Handbook* also presents the following appendices:

Appendix A:	Topical Index
Appendix B:	Effective Dates of Statements, Interpretations, Technical Bulletins, and Technical Releases
Appendix C:	Memorandum of Understanding
Appendix D:	Federal Accounting and Auditing Resources
Appendix E:	Consolidated Glossary
Appendix F:	Consolidated List of Acronyms

Materiality

The Board intends that application of authoritative guidance be limited to items that are material. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

The accounting and reporting provisions of the Board’s accounting standards need not be applied to information if the effect of applying the provision(s) is immaterial. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances. Refer to Statement of Federal Financial Accounting Concepts 1, Objectives of Federal Financial Reporting, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.

Hierarchy of Generally Accepted Accounting Principles

The term “generally accepted accounting principles” has a specific meaning for accountants and auditors. The AICPA *Code of Professional Conduct* prohibits members from expressing an opinion or stating affirmatively that financial statements or other financial data “present fairly... in conformity with generally accepted accounting principles,” if such information contains any departures from accounting principles promulgated by a body designated by the AICPA Council to establish such principles. The AICPA Council has designated FASAB as the body that establishes accounting principles for federal entities. See SFFAS 34 for information on the GAAP hierarchy.

Copyright

Preamble to Statements of Federal Financial Accounting Concepts

Each Statement of Federal Financial Accounting Concepts (SFFAC) is part of a series of concepts statements intended to set forth objectives and fundamentals on which financial accounting and reporting standards will be based. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial accounting-concepts that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties.

The Federal Accounting Standards Advisory Board's (FASAB or "the Board") conceptual framework enhances the consistency of standards and serves the public interest by providing structure and direction to federal financial accounting and reporting. The most direct beneficiaries of the FASAB's concepts statements are the Board itself and preparers and auditors of federal financial reports. The statements guide the Board's development of accounting and reporting standards by providing the Board with a common foundation and basic reasoning on which to consider the merits of alternatives.

Knowledge of the objectives and concepts the Board considers should help users and others who are affected by or interested in federal financial accounting and reporting standards to understand better the purposes, content, and qualitative characteristics of information provided by federal financial accounting and reporting. That knowledge should enhance the usefulness of, and confidence in, federal financial accounting and reporting.

Concepts statements enhance preparers' and auditors' understanding of the common foundation and reasoning employed in considering alternatives. The GAAP hierarchy provides that statements of federal financial accounting standards constitute level A (the highest level) guidance. Statements of federal financial accounting concepts are not GAAP. Instead, concepts statements constitute "other literature" and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature. In developing and amending accounting standards, the Board looks to concepts statements for guiding principles and also considers relevant existing standards and guidance issued by the Board and other standard setting bodies. Until the Board amends existing standards, the Board expects practice to be governed by the accounting principles embodied in the four levels of the GAAP hierarchy. Thus, the Board distinguishes between material presented in concepts which are used to guide Board deliberations on future GAAP and accounting principles presented in standards which constitute current GAAP.

For federal entities, in the absence of specific authoritative literature applicable to a transaction or event, it should be possible to report the event or transaction by selecting an established accounting principle for an analogous transaction or event that appears appropriate when applied in a similar manner. In the unusual case where an analogy cannot be drawn to established authoritative literature, the GAAP hierarchy permits consideration of other literature including concepts statements. Consideration of individual concepts statements will be helpful but often may not provide sufficient guidance in resolving emerging issues. Therefore, the Board encourages careful study of the conceptual framework and established practice in resolving such issues.

Statements in this series describe concepts and relations that will underlie future federal financial accounting standards and practices and in due course will serve as a basis for evaluating existing standards and practices. With issuance of this statement, the series of concepts statements comprises:

- SFFAC 1, *Objectives of Federal Financial Reporting* (includes the qualitative characteristics of information in financial reports)
- SFFAC 2, *Entity and Display*
- SFFAC 3, *Management's Discussion and Analysis*
- SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*
- SFFAC 5, *Elements of Accrual-Basis Financial Statements and Basic Recognition Criteria*
- SFFAC 6, *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*
- SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*
- SFFAC 8, *Federal Financial Reporting*
- SFFAC 9, *Materiality: Amending SFFAC 1, Objectives of Federal Financial Reporting, and SFFAC 3, Management's Discussion and Analysis*

Like other pronouncements of the FASAB, Statements of Federal Financial Accounting Concepts remain in effect until amended, superseded, or withdrawn by appropriate action under the Board's Rules of Procedure.

Statement of Federal Financial Accounting Concepts 1: Objectives of Federal Financial Reporting

Status

Issued	September 2, 1993
Affects	None.
Affected by	SFFAC 3 affects paragraph 181 by providing guidance on MD&A. SFFAC 9, amends paragraph 164 and inserts a chapter titled Materiality between the current chapters 6 and 7.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

This document is a conceptual statement on the objectives of financial reporting by the federal government. It focuses on the uses, user needs, and objectives of such reporting. The objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government to (1) demonstrate its accountability, (2) provide useful information, and (3) help internal users of financial information improve the government's management. In addition to guiding the Board, the objectives may serve as useful guidance to others involved in federal financial reporting. For example, the objectives may be useful in developing accounting policy, designing reports, and writing narratives and notes to financial reports.

The objectives reflect the federal environment. They also consider many of the needs expressed by current and potential users of federal financial information. They provide a framework for assessing the existing financial reporting systems of the federal government and for considering how new accounting standards might help to enhance accountability and decision-making in a cost-effective manner.

The four objectives of Federal Financial Reporting are:

> <u>Budgetary Integrity</u>—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. Federal financial reporting should provide information that helps the reader to determine
>
> - how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
> - the status of budgetary resources, and

- 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.

Operating Performance—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. Federal financial reporting should provide information that helps the reader to determine

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship—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. Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

Systems and Control—Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.

Table of Contents

Executive Summary

Introduction

1. This document is a conceptual statement on the objectives of financial reporting by the federal government. It focuses on the uses, user needs, and objectives of such reporting. Statements on concepts, such as this document, differ from statements of recommended accounting standards. Statements on concepts are more general than statements of standards and do not contain specific recommendations that would, when issued by the Board's sponsors, become authoritative requirements for federal agencies and auditors.

2. Instead, statements on concepts, after approval by the Board's sponsors, provide general guidance to the Board itself as it deliberates on specific issues. They also help others to understand federal accounting and financial reports.

3. The objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government to (1) demonstrate its accountability to internal and external users of federal financial reports, (2) provide useful information to internal and external users of federal financial reports, and (3) help internal users of financial information improve the government's management.

4. The objectives reflect the federal environment. They also reflect many of the needs expressed by current and potential users of federal financial information. They provide a framework for assessing the existing financial reporting systems of the federal government and for considering how new accounting standards might help to enhance accountability and decision-making in a cost-effective manner.

5. The FASAB notes that many information sources other than financial statements help to attain these objectives. The objectives relate to the management and financial reporting systems in the federal government in their entirety.

6. Listing the objectives does not imply a judgment about the extent to which they are now being attained. Indeed, it is presumed that the objectives are being met to some degree now. However, the federal government does not have an integrated mechanism for reporting within the context of these objectives. The FASAB will consider where new accounting standards could make a useful and cost-effective contribution to improving the extent to which these objectives are attained.

7. The Department of the Treasury, the Office of Management and Budget, and the Government Accountability Office expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards.

Background and Rationale

8. The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the citizens, their elected representatives, federal executives, and program managers. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government. Providing this information to program managers, executives, and members of Congress is essential to planning and conducting government functions economically, efficiently, and effectively for the benefit of society.

9. Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. Financial reporting can, however, make a useful contribution toward fulfilling those goals.

10. The objectives apply to both internal and external financial reports. They are intended to improve the relevance, consistency, and quality of accounting and other data available for a wide variety of applications.

11. The FASAB and its sponsors believe that any statement of objectives of federal financial reporting must be based on the needs of those who use the reports. Those users include citizens, Congress, federal executives, and federal program managers. Current and potential users of federal financial information want information to help them assess how well the government is doing by answering questions regarding such topics as:

- **Budgetary integrity:** What legal authority was provided for financing government activities and for spending the monies? Were the financing and spending in accordance with these authorities?
- **Operating performance:** How much do various programs cost, and how were they financed? What outputs and outcomes were achieved? What and where are the important assets, and how effectively are they managed? What liabilities arose from operating the program, and how will they be liquidated or provided for?
- **Stewardship:** Did the government's financial condition improve or deteriorate? What provision was made for the future?

- **Systems and Control:** Does the government have cost-effective systems and controls to safeguard its assets? Is it able to detect likely problems? Is it correcting deficiencies when detected?

12. Concerns like these define the following objectives of federal financial reporting.

Objectives of Federal Financial Reporting

Budgetary Integrity

13. 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. Federal financial reporting should provide information that helps the reader to determine

- how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
- the status of budgetary resources, and
- how information on the use of budgetary resources relates to information on the costs of programs operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Operating Performance

14. Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity;[1] the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and

[1]The FASAB has not yet considered criteria for defining, and terminology for describing, federal financial reporting components or units. In this document, therefore, the term "entity" is used in a generic way to refer, depending on the context, to the U. S. government as a whole; to organizational component units of the government, such as an agency; and to other kinds of potential reporting units, such as programs.

- the efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship

15. 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 conditions have changed and may change in the future.

16. Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

Systems and Controls

17. Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purpose authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.

Organization of the Statement

18. The first two chapters of this statement present background information on the Board and the federal environment. Chapter 3 identifies the four groups of current and potential users of federal financial reports and gives examples of some of their information needs. Chapter 4 states and explains the objectives of federal financial reporting in more detail than does this executive summary.

19. Chapter 5 explains some limitations of the standard-setting process within the context of user needs. Chapter 6 discusses the desirable qualitative characteristics of financial

information. Chapter 7 identifies the users, scope, and factors to consider when applying materiality in the federal environment. Chapter 8 explains how accounting supports federal financial reporting. Chapter 8 explains how financial reporting supports reporting on operating performance.

20. Appendix A sets forth the basis for the Board's conclusions. Appendix B presents a categorization of user needs according to types of information identified by the users rather than according to objectives. Appendix C lists some major federal reports that are regularly produced.

Chapter 1: Federal Financial Reporting And The Role Of The Federal Accounting Standards Advisory Board

21. Financial reporting by the federal government provides information for formulating policy, planning actions, evaluating performance, and other purposes. In addition, the processes of preparing and auditing financial reports can enhance the government's overall accountability structure by providing greater assurance that transactions are recorded and reported accurately, that consistent definitions are used to describe the transactions, etc. Thus, federal financial reporting helps to fulfill the government's duty to manage programs economically, efficiently, and effectively and to be publicly accountable.

22. Financial reporting is supported and made possible by accounting and accounting systems. "Financial reporting" may be defined as the process of recording, reporting, and interpreting, in terms of money, an entity's financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements.[2]

Role Of The FASAB In Federal Accounting And Financial Reporting

The mission of the FASAB is to recommend accounting standards [for the federal government] after ... considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information.[3]

23. The FASAB and its sponsors believe that any description of federal financial reporting objectives should consider the needs of both internal and external report users and the decisions they make. This implies a different role for the FASAB than for the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). The FASB sets financial reporting standards for privately owned entities in the United States. The GASB sets financial reporting standards for state and local governments.

[2]Except where the context indicates otherwise, the term "government" in this document refers both to the U.S. government as a whole and to its component reporting entities, such as agencies and programs.

[3]From the FASAB Mission Statement, approved by the Board and by the Secretary of the Treasury, the Director of OMB, and the Comptroller General of the United States in 1991.

24. Those Boards exist primarily to set standards for general purpose financial reporting to external users of financial reports. This is because those users, by definition, have limited ability to control the nature of the information made available to them. The FASB and the GASB do not need to weigh heavily managers' information needs because those individuals, by definition, are assumed to have ready access to the information they need about the financial transactions and events that affect the financial position, operations, and financial condition of the entities they manage.

25. The FASAB, on the other hand, considers the information needs of both internal and external users. In part, this is because the distinction between internal and external users is in many ways less significant for the federal government than for other entities. Officials who in theory should have ready access to information often find in practice that it is not available. Factors that contribute to this problem include the size and complexity of the government, the rapid turnover among senior political executives compared with the time required to install information systems in large bureaucracies, and the division of authority in the federal government.

26. The FASAB's dual concern, with both internal and external reporting, is the result of such factors and of the Board's mandate. The FASAB was created to advise OMB and Treasury (agents of the President) and the GAO (an agent of the Congress) on accounting standards for federal agencies and programs in order to improve financial reporting practices.

27. The Board's sponsors have separate constitutional and statutory authorities for setting accounting policy for the government. The division of powers in the U.S. government means that different policymakers with independent authority find it useful to have a mechanism to coordinate their accounting policy activities. The Board and its public deliberative process also provide a new arena for the participants to deliberate and to discover how federal accounting and financial reporting can be improved.

28. Just as the traditional distinction between internal and external report users is less useful in the federal context, some of the traditional ways of classifying financial *reports* are less relevant. Reports can be intended primarily for a designated special purpose or for general purpose use. In the federal government, as in most entities, internal financial reporting is designed for special purposes. Internal financial reporting helps managers to plan, conduct, and coordinate their activities and to evaluate the economy, efficiency, and effectiveness of their programs.

29. Much external federal financial reporting also is for special purposes, but some is for general purpose use; that is, it attempts to meet the common needs of many different users who have limited power to demand information directly. These reports are known as general purpose reports.[4]

Limitations Of Financial Reporting

30. The FASB and the GASB focus primarily on general purpose financial reporting because that is their mandate and reason for being. Even so, those Boards recognize that general purpose financial reporting is not the only source of financial information about such entities. In many cases, users of general purpose financial reports need to consult other sources to satisfy their information needs. This is no less true for the federal government.

31. While certain information is provided by general purpose financial reports, other information is better provided by, or can be provided only by, financial reporting outside such reports. Still other information is provided by nonfinancial reports or by financial reports about segments of the national society other than the federal government and its component entities (e.g., economic reporting).

32. Often, to satisfy the information needs of various individuals, it is necessary to combine and report financial and nonfinancial information. Often, combining information about the government with information about aspects of the national society is necessary to assess past or planned governmental actions. For example, information about the number of people gainfully employed after participating in a vocational education program would be important both in assessing past governmental expenditures for training and in evaluating plans for similar new expenditures.

33. Some questions arise with special force regarding the nature of general purpose reports because, by definition, no user or potential user is able unilaterally to define the requirements for these reports. The FASAB is, by design, well constituted to consider the issues involved with such reports.

34. Federal accounting also must support special purpose reporting to the Congress, executives, and others that the FASAB represents. Indeed, most federal financial reporting is special purpose reporting. Also, the Board notes that traditional “general purpose”

[4]In state and local governmental accounting, the term “general-purpose financial statements (GPFS)” has a quite specific meaning. Standards published by the GASB define in detail the form and content of such reports. The term “general-purpose reports” is used in a more generic sense in this document to refer to a variety of federal financial reports.

financial reports may serve a larger and more useful purpose for a variety of audiences if traditional designs for such reports are expanded to include a variety of reports addressing budgetary integrity, operating performance, stewardship, and control of federal activities.

Evolutionary Approach

35. 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.

36. 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.

37. In developing specific standards, the FASAB will consider the needs of financial information users, the usefulness of the information in relation to the cost of developing and providing it, and the ability of accounting standards to address those needs compared with other information sources.

Background Information On Federal Financial Reporting

38. Different people are likely to talk about very different things when asked to describe federal financial reporting or federal accounting. A few examples will illustrate this point

39. **An economist**, when asked this question, is likely to refer to reports about the national society as a whole. Among the most important of such financial reports are the national income and product accounts (NIPA) that measure the nation’s aggregate expenditures on currently produced output. Federal government expenditures, of course, constitute a significant fraction of the total expenditures in the economy. The NIPAs, as a system, emerged in the 1940s and were built on work done in the U.S. Department of Commerce beginning in the 1930s and earlier by private organizations.

40. The NIPAs provide a picture of the economic transactions that occur in an accounting period, such as a year. The approach is to provide such a picture through a set of accounts that aggregate the accounts belonging to the individual transactors in the economy—workers, businesses, and consumers, among others—whether or not formal accounting statements exist explicitly for all of them.

41. The NIPAs provide vital information to policymakers and others who are planning future actions and to individuals who would like to assess the effects of past actions. The NIPAs are recognized as an essential part of economic reporting by national governments. For this reason, the United Nations has developed the System of National Accounts (SNA). The SNA is a comprehensive, integrated, and internationally comparable statistical base for analysis in key policy-making areas, such as economic growth, inflation, and productivity.

42. This Statement does not deal directly with such accounts of the economic activity of the national society. The focus of this Statement is on accounting systems and financial reports that deal with the budgetary integrity, operating performance, and stewardship of the government as such; that is, of the government as a legal and organizational entity within the national society. However, to report on some aspects of the government's performance and stewardship, economic and other information about the national society is essential. Thus, the FASAB may consider whether such economic information should be included in certain financial reports, such as general purpose financial reports for the U.S. government as a whole.

43. **A financial analyst** on Wall Street, when asked about federal financial reporting, is likely to think of the "Daily Treasury Statement" and the "Monthly Treasury Statement of Receipts and Outlays of the United States Government." Some financial analysts study these Treasury reports regularly to assess the effect of cash flows on bank reserves and the size of the government's borrowing requirements. The federal government's borrowing is viewed as free of default risk because of the government's ability to tax and to create money. The power to tax depends on the government's willingness to tax and the strength of the economy.

44. From a longer-term perspective, it is true, however, that borrowers' expectations about such factors as future inflation and the relative value of the dollar compared with other currencies can influence the borrowing costs of the United States. Those expectations, in turn, may be influenced by the deficit reported or projected by the government, the current inflation rate, and other factors.

45. **Someone concerned with formulating or executing the U.S. budget**, when asked about the "federal accounting model," is likely to think of the budgetary accounting system. This is the system used to keep track of spending authority at various stages of budget execution from appropriation through apportionment and allotment to obligation and eventual outlay. This system is used by Congress and the executive branch for such purposes as "scoring" the budget and for assessing the economic implications of federal financial activity at an aggregate level. It also is used for planning and controlling government operations at more detailed, disaggregated levels. Of course, people involved

with the budget also are informed by, and rely on, sources of information other than the budgetary accounting system, e.g., program evaluation and performance measures.

46. Although the FASAB does not recommend standards for the budget or budget concepts, part of its mission is to recommend accounting principles that will help provide relevant and reliable financial information to support the budgetary process. Furthermore, information about budget execution is essential to assessing budgetary integrity.

47. **Accountants working for the federal government, individuals auditing government programs, or students in a governmental accounting course** are likely to think first of what are known within the federal government as the “proprietary” accounts and the reports prepared, in part, from information in them. These accounts are used to record assets and liabilities that are not accounted for in the budgetary accounts. These reports are said to present “financial position” and “results of operations” in accordance with some set of accounting standards. The FASAB is most directly concerned with these accounts and with the reports that are prepared, in large part, with information from them.

48. Attention to this and other aspects of federal accounting and financial reporting has been greatly increased by the Chief Financial Officers Act of 1990 (CFO Act). This act mandates improved financial management by requiring, among other things, (1) new financial organizations, (2) enhanced systems, and (3) audited financial reporting. However, the FASAB’s area of concern is not limited to the reports required by the CFO Act.

Chapter 2: The Federal Accounting And Financial Reporting Environment

49. Financial reporting is an important, basic tool in the management and oversight of most organizations. It is particularly important for the federal government because of the government’s fundamental nature and responsibilities and because the federal government operates with fewer external restraints than other entities. Federal accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment of the federal government, as discussed below.

Sovereignty

50. The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power.[5] The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

Separation Of Powers

51. Because of their concern about potential abuse of the national government's power, the founders designed a government characterized by the separation of powers. Each branch of government—legislative, executive, and judicial—is checked and constrained by the others. Paradoxically, this same separation of power can obscure responsibility and reduce accountability. The interrelated responsibilities of the legislative and executive branches, for example, can make it difficult to assign responsibility for the policies that are adopted.

Federal System Of Government

52. The federal system of government— comprising federal, state, and local levels of government—also makes it difficult to pinpoint accountability for many programs. The federal government's responsibility relative to that of the states has gradually expanded. The federal government has undertaken responsibilities in areas such as income redistribution, education, and health care. Often, however, the expansion has come without direct federal control over related operations. Responsibilities and financial resources of the three levels of government have become intermingled. Citizens are not

[5]The word "sovereign," much discussed by legal and political philosophers, is used here in its broad, popular sense to imply (1) internally that the people are the ultimate (if indirect) overseer or authority in the decision-making process of a democratic state and (2) externally that the state is autonomous or independent. As noted by one authority on the subject, either type of sovereignty, internal or external, implies that there is no higher agency. In a more limited sense, sovereignty is the power to make or change the law, a power exercised collectively by individuals and institutions operating in a complex system of relationships. See "Sovereignty," W. J. Stankiewicz, The New Encyclopedia Britannica, 15th. ed. (1976), vol. 17, pp. 309-313.

clear about who is in charge, where to press for performance, and whom they should blame for bad results.

Responsibility For The Common Defense And General Welfare

53. The federal government is unique in that it has continuing responsibility for the nation's common defense and general welfare. As a result, the government's financial condition is necessarily a secondary consideration in many cases. For example, the nation would enter into military conflict to protect its vital national interests despite the fact that doing so would worsen an already large deficit. (Similarly, the government's greatest resource is one that it does not own but can tax: the national economy.)

54. Further, providing for the nation's general welfare is a broad responsibility that involves multiple goals. There is no single measure of success (like "return on investment" or "earnings per share"). Goals often are not explicitly defined in quantifiable terms and sometimes conflict with each other. Relevant measures of performance are usually nonfinancial. For example, many federal loan programs are charged with two conflicting goals: (1) to operate as a fiscally prudent lender and (2) to provide high-risk lenders with credit.

Power To Tax, Borrow, And Create Money

55. As stated, the federal government has unique access to financial resources and financing. It has the power to tax, to borrow, and to create money. These powers give the government a call on the underlying wealth of the United States—a vast but finite pool of resources.

56. There is no constitutional requirement to provide sufficient revenues to fund expenditures of the federal government. There is a statutory limit on the amount of U.S. debt. This limit is routinely increased by Congress and the President. The federal government's ability to finance its debt has not been constrained by capital market assessments of its creditworthiness. It is true, however, that the cost of servicing the U.S. debt now constrains the range of feasible fiscal and monetary policies more than was formerly the case.

57. The federal government—through the Federal Reserve—also has the power to create money and to control its supply.[6] This ensures that creditors will be repaid, at least in nominal terms. When the government's debt is large, it also provides a temptation to create money, as well as inflation.

[6]The Federal Reserve Board functions as a largely independent entity but is, of course, a government agency created by congressional action.

Influence Of Organized Interests

58. Because of the size and nature of government programs, it is difficult for individuals to evaluate or to influence policies and actions of the federal government. Typically, individuals must organize to exercise influence. Small groups whose members are significantly affected by a common factor or concern can be organized relatively easily, but they may find it difficult to wield much influence. Large groups may be influential, but organizing them is difficult if the members have common but diffuse interests. Once organized, interest groups tend to perpetuate themselves.

59. As a result, most elected and appointed federal officials, and the groups to which they are responsive, have been interested primarily in information about individual government programs, functions, or activities. They have been less interested in information about the government as a whole and even less concerned about intermediate levels of reporting, such as individual departments.

Political System Versus Private Markets

60. The federal government is not subject to the discipline of competitive markets for private goods, services, and capital. Generally, transactions between citizens and the government are not individual exchanges between willing buyers and willing sellers. Taxpayers provide resources involuntarily, based on their consumption, wealth, or income rather than on their desire for particular government services. Even when user fees are charged, they often are not intended to represent market clearing prices—prices that would, in markets for private goods, balance supply and demand.

61. Thus, citizens as individuals have little say in selecting the public services they pay for. Decisions on what public services will be provided are collective decisions made through the political process. Politically influential recipients of benefits can force less influential non-recipients to bear the cost of the benefits.

62. Further, because most governmental revenues are not earned in individual, voluntary, exchange transactions, no private market directly measures the value of output. Consequently, the value added to society's well-being by government programs cannot be gauged by conventional measures of net income, nor is there much competitive market constraint on the quantity or quality of services provided. Instead, decisions about the quantity, quality, and value of public services are collective decisions made by the political process.

Assets

63. The government makes significant investments in assets, including public domain assets and large investments intended to produce growth (educational programs and research and development, for example).

64. In government, as in the private sector, assets are expected to provide benefits that outweigh costs. In the private sector, the notion of benefits is relatively straightforward: benefits are measured in terms of cash inflows. Assets are not acquired unless the value of expected cash flows exceeds acquisition costs.

65. In the government, this discipline does not usually exist. Expected benefits often are not cash inflows but rather are the services provided by the asset. Sometimes those services are provided to the government itself (e.g., government office buildings or motor pools). More often, the services are provided to the public (e.g., education and research and development).

Responsibility To The News Media

66. The federal government is subjected to, and should encourage, scrutiny by the news media. Because of the lack of external restraints and because the government's power ultimately resides in the citizens, it has a special responsibility to citizens and taxpayers to disclose its activities.

Importance Of The Budget

67. The budget is the most widely recognized and used financial report of the federal government. It is a principal surrogate for the missing external restraints discussed above. It is a vehicle for the political process to reach agreement on goals and to allocate resources among competing priorities. It provides a system for controlling expenditures. And it supplies information necessary for assessing the effect on the economy of the government's fiscal policies. The role of budgeting in financial reporting is discussed further in Chapter 7 under "Relationship of Financial Reporting to Budgeting."

Need For Special Control Mechanisms

68. The lack of external restraints noted above creates a need for special control mechanisms. Some mechanisms exist today. The most important, of course, are the political constraints

and accountability imposed by regular elections and the separation of powers and the other constitutional constraints and accountabilities, such as the federal system and freedom of speech.

69. Accounting and financial reporting also play a role. Budgetary obligation accounting is used to control activities, primarily at the budget account level. Audited financial reports can provide users with assurance that accounting systems are providing consistent and reliable data.

70. However, the need for improvement in financial reporting is widely recognized, as is the fact that financial information alone often is insufficient for decision-making. For example, financial information on costs often must be combined with nonfinancial information on performance to provide a basis for assessing the efficiency and effectiveness of government programs.

Chapter 3: Accountability And Users' Information Needs—the Foundation Of Governmental Financial Reporting

71. It may be said that "accountability" and its corollary, "decision usefulness," comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability. Similarly, because a democratic government is accountable for operating economically, efficiently, and effectively, for the purposes intended by citizens and their elected officials, certain other conclusions logically follow. Specifically, those who formulate, select, and implement government policies and programs need information useful for planning, controlling, and conducting government functions.

72. The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability. Accordingly, this Chapter first discusses the concept of accountability, then identifies the four groups of users of federal financial reports. It concludes by providing some examples of the information needs that may be addressed to some extent by federal financial reports.

Accountability

73. Several different kinds of accountability can be distinguished, and a given piece of information may be relevant in different ways to judgments about accountability. For example, one authority suggests that there are five levels or types of public accountability:

- Level 1 is policy accountability—selection of policies pursued and rejected (value).
- Level 2 is program accountability—establishment and achievement of goals (outcomes).
- Level 3 is performance accountability—efficient operation (efficiency and economy).
- Level 4 is process accountability—using adequate processes, procedures, or measures in performing the actions called for (planning, allocating, and managing).
- Level 5 is probity and legality accountability—spending the funds in accordance with approved budget and/or approved items (compliance).[7]

74. In a democracy, appointed officials are accountable to their superiors, and elected officials are accountable to the citizens for each of these kinds of accountability. Accounting and financial reporting can help elected and appointed officials to maintain and to demonstrate their accountability. The last kind of accountability listed, for "probity and legality," probably is the kind most often associated by the public with accounting. However, the accounting profession has long recognized that accounting can and should contribute to achieving and demonstrating several kinds of accountability, such as

- accountability for financial resources;
- accountability for faithful compliance or adherence to legal requirements and administrative policies;
- accountability for efficiency and economy in operations; and
- accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness.[8]

[7]J. D. Stewart, "The Role of Information in Public Accountability," eds. Tony Hopwood and Cyril R. Tompkins, Issues in Public Sector Accounting (Oxford, Great Britain: Philip Allan, 1984), pp. 14-15, as cited by the GASB in its Preliminary Views on Service Efforts and Accomplishments Reporting (Dec. 1992).

[8]Report of the Committee on Concepts of Accounting Applicable to the Public Sector, American Accounting Association (1970-71), pp. 80-81, as cited by the GASB in Preliminary Views on Service Efforts and Accomplishments Reporting (Dec. 1992).

Users Of Federal Financial Reports

75. The Board believes that users of financial information about the federal government can be classified in four major groups: citizens, Congress, executives, and program managers.

Citizens

76. This group includes individual citizens (without regard to whether they are taxpayers, voters, or service recipients). Citizens include the general news media and more specialized users, such as trade journals; public interest and other advocacy groups; state and local legislators and executives; and analysts from corporations, academe, and elsewhere.

77. Citizens are interested in many aspects of the federal government. They are concerned about individual programs, candidates for office, the services the government provides, and the fiscal responsibility of their elected and appointed representatives. Citizens receive and pay for government services and therefore are concerned with the outputs and outcomes of those services and the efficiency with which they are provided. Citizens are concerned about their families and, in particular, with the financial burden their children and grandchildren will inherit. As individuals, citizens typically have limited time and ability to analyze reports about their government; they want and rely on assurances that the government is functioning economically, efficiently, and effectively. As they are organized and represented by analysts working for interest groups and the news media, citizens want more information about the government’s activities.

78. Citizens express their interest in the government by discussing issues, by voting, and by writing to their representatives about the quality and quantity of the services they receive. In some cases, citizens may decide whether and when to use services and products provided by the government. They may contribute to political campaigns, demonstrate support or opposition for individuals responsible for past and proposed government actions, and even run for office.

Congress

79. This group includes elected members of Congress and their staffs, including staff of the Congressional Budget Office (CBO) and the GAO. Congress is concerned with broad policies, priorities, and the programs that implement those priorities. It decides what taxes to impose, what funds should be spent, and for what purpose. Thus, Congress is concerned both with how to finance programs and with how they are executed.

80. Congress participates—along with the administration—in the basic decisions that describe the intent of government. Such decisions include passing laws in response to public demand, allocating resources among competing programs, and establishing policy that affects various aspects of the country's economic and social life. These decisions often are influenced by assessing costs and benefits and by considering the effect of the government's aggregate financial requirements on the economy.

81. Congress also participates in monitoring government programs. It assesses the management performance of the executive branch and the efficiency and effectiveness of programs.

Executives

82. This group includes the President and those acting as his agents, i.e., program agency heads and their deputy, under, and assistant agency heads; heads of bureaus, administrations, services, and agencies; and the central agency officials in OMB and the Department of the Treasury.

83. Executives, like Congress, are concerned with the government's goals, objectives, and policies. Executives focus on the strategic plans and programs that are intended to achieve presidential and congressional goals and to implement their policies. In particular, they pay attention to budgets that, from the perspective of each agency, are the source of the resources needed to achieve goals and to implement policies. Executives are, of course, directly concerned about the management of programs, that is, with the actual delivery of services and with the efficiency and effectiveness of the delivery process.

84. Executives develop legislative proposals, recommend the necessary level of program funding, and formulate financing and revenue-raising strategies. They help select the method for delivering services. They determine whether program managers have been accountable for the resources entrusted to them and whether programs are operating efficiently and effectively. Executives also provide information that will enable the President and Congress to monitor programs.

Program Managers

85. This group includes individuals who manage government programs. Their concerns include operating plans, program operations, and budget execution.

86. Program managers assist in the design of programs and organize the method selected for delivering services. They recommend program budgets based on detailed plans that set forth needs for money, staffing, facilities, and inventory.

87. Program managers establish operating procedures for their programs and manage them within the limits of the spending authority granted by Congress. They select, supervise, and evaluate personnel. They also make sure that program inventory and facilities are acquired economically, maintained adequately, and used efficiently. Program managers need to provide information to enable executives and Congress to monitor the programs.

The Needs Of Users Of Federal Financial Reports

88. While the financial information needs of these groups is more diverse than their membership, those needs can be categorized under four broad headings.

Budgetary Integrity

89. All user groups need information about the budget. For citizens, information about budget execution provides assurance that their elected and appointed representatives have fulfilled their most basic fiduciary responsibility: to raise and spend money in accordance with the law.

90. For the President’s economic team and for congressional budget committees, information is needed on budget aggregates (total budget authority, total receipts and collections, and total outlays) to establish fiscal policy, including governmental financing needs. These officials need to know that prior-year “actuals” have been accurately recorded in accordance with the same budgetary principles used to prepare estimates.

91. To avoid violations of the Anti-Deficiency Act and the Impoundment Control Act, program managers need information about obligations incurred on their programs. They need periodic information about the status of budgetary resources, that is, the extent to which the resources have been used or remain available. They also want to know whether budgetary resources are available to be used for other purposes through reprogramming.

Operating Performance

92. Citizens want information about programs that affect them. Veterans, for example, want to know about new hospitals, and defense workers want information about contract awards (and cancellations). Retirees and people planning retirement—and their representatives in Congress—want to know that the Social Security Administration provides reliable services to the public.

93. Congress and executives want information about the comparative costs of programs (such as the per student cost of the Job Corps Program versus that of other job training programs). For comparisons to be valid, costs must be defined and measured alike.

94. Of course, information on the effectiveness of programs is also needed to make valid comparisons among programs. Information is needed about outputs (e.g., number of students who graduated) and outcomes (e.g., number of students who got and held jobs for which they were trained).

95. Executives and program managers need to know the cost of performing work reimbursed by other government entities or by nonfederal customers. Costs, in this case, would measure the resources (personnel, material, and equipment) used to accomplish the work.

96. Congress and executives often want cost information that would help to compare alternative courses of action. How much more or less would it cost if the Census Bureau used a new approach to taking the census? How much would be saved if an Army division were based in the United States rather than in Europe?

97. Program managers need information on the assets and liabilities related to operations. Managers of loan programs need information on the quality of their loan portfolios. Managers of repair depots want information on inventories, such as their value, quantity, location, age, and condition. Managers of government facilities need to know the facilities' condition and an estimate of future outlays made necessary by deferring needed maintenance.

98. Congress and executives need information about the market value of assets that could be sold, such as precious metals or other commodities.

Stewardship

99. Citizens, Congress, executives, and program managers need information to assess the effect of the government's activities on its financial condition and that of the nation. Information is needed about the financial outlook for both the short and the long term.

100. Information is needed on the government's exposure and risks associated with deposit insurance, pension insurance, and flood insurance. People need to know about likely future expenditures for cleaning up nuclear weapons sites and military bases. They want information that will help them assess the likelihood and amount of future claims that might arise from government-sponsored enterprises.

101. All users need information on earmarked revenues recorded in trust funds. They want to know, for example, whether the Social Security Trust funds are likely, in the foreseeable

future, to need infusions of new taxes to pay benefits. Citizens need to know the implications of investing trust fund revenues in government securities.

102. Users also need trend information on spending on investments in physical and human capital versus spending on consumption.

Systems and Control

103. Users at all levels need information on internal controls and the adequacy of financial management systems. Citizens want assurances that systems and controls are in place to protect the resources they supply to the government. They want to know that operating procedures and processes provide reasonable assurance that those resources are used economically and efficiently for the purposes intended. Congress, executives, and program managers need to demonstrate to those to whom they are accountable that they have, in fact, protected those resources and used them well. Users want to know, for example, that agency heads have determined that internal controls are adequate, that basic financial statements are auditable, and that high-risk areas have been identified and addressed.

104. The implications of these four broad categories of information needs for the objectives of federal financial reporting are discussed in more detail in the next Chapter.

Chapter 4: Objectives Of Federal Financial Reporting

105. The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government. Providing this information to program managers, executives, and members of Congress is essential to planning and conducting the government’s functions economically, efficiently, and effectively for the benefit of society.

106. Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. Financial reporting can, however, make a useful contribution toward those objectives.

107. The objectives discussed below apply both to internal and to external financial reports. To some degree, they also apply both to special purpose and to general purpose reports. Users of general purpose financial reports may have difficulty obtaining relevant information to hold the federal government accountable if the government operates without appropriate reporting objectives and accounting standards. The Board also intends that these objectives and the ensuing standards will prove widely useful for other purposes, though they may not apply to every special report or every item in the accounting system. The objectives are intended to improve the relevance, consistency, and quality of accounting and other data available for a wide variety of applications.

108. The Board expects that its recommendations will be applied to improve information for program management and executive and legislative branch decision-making. The Department of the Treasury, OMB, and the GAO expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards.

109. Four major objectives are proposed, around which accounting standards should be organized. These objectives are designed to help ensure the accountability of the federal government and to better inform decisions influenced by financial information about the government. Each objective reflects the federal environment and meets many of the needs expressed by current and potential users of federal financial information. 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 be able to enhance those systems in a cost-effective manner.

110. Current and potential users of federal financial information want information to help them assess how well the government is doing by answering questions regarding topics like those below:

- **Budgetary Integrity:** What legal authority was provided for financing government activities and for spending the monies? Were the financing and spending in accordance with these authorities? How much was left?
- **Operating Performance:** How much do various programs cost, and how were they financed? What outputs and outcomes were achieved? What and where are the important assets, and how effectively are they managed? What liabilities arose from operating the program, and how will they be provided for or liquidated?
- **Stewardship:** Did the government's financial condition improve or deteriorate? What provision was made for the future?
- **Systems and Control:** Does the government have cost-effective systems and controls to safeguard its assets? Is it able to detect likely problems? Is it correcting deficiencies when detected?

111. Concerns like these define the objectives of federal financial reporting. In the following text, objectives and subobjectives are stated in bold italic type. Each of the objectives and subobjectives is followed by a commentary that explains some of the implications of the objective.

Budgetary Integrity

Objective 1

112. **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.**

113. This objective arises generally from the responsibility of representative governments to be accountable for the monies that are raised and spent and for compliance with law. More specifically it arises from the requirement in Article I, Section 9 of the Constitution of the United States 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." Its focus is the Budget of the United States Government, the President's annual budget submission to the Congress, which is the government's principal financial report, and the laws enacting budget authority for a given fiscal year. The Budget of the United States Government is the initial frame of reference within which Congress and the President enact the laws that require the payment of taxes and provide the authority to obligate and spend money.

114. The focus of this objective is retrospective. That is, the focus is on recording actual data from budget execution against appropriations made by Congress using existing budgetary standards. Thus, it would validate the "actual" column shown in the Budget of the United States Government. It would also provide data that could be shown in other reports as a statement of budget execution or a statement of the status of budgetary resources. The data also could be displayed in analytical tables showing, for example, the historical pattern of receipts and outlays.

115. Certain subobjectives arise from the basic objective of budgetary integrity, as discussed below.

Federal financial reporting should provide information that helps the reader to determine:

116. **1A. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.**

117. Considering this objective in conjunction with the specific information needs identified by the Board suggests some examples of information that might help meet this objective:

- government receipts and offsetting collections reported in total and by composition;
- obligations according to the nature of services or items procured;
- information about the extent of compliance with the budget and laws, and whether money was expended as intended by the federal government and its grantees; and
- valid data on budget authority, obligations, and outlays by program and for all appropriation and fund accounts (summarized appropriately to fit the intended audience).

118. **1B.The status of budgetary resources.**

Examples of information that could help meet this objective include

- information about the sufficiency of budget authority for covering commitments and the status of obligated and unobligated balances of budgetary resources and
- assurances that funds authorized for a given purpose were actually spent for that purpose.

119. **1C.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.**

120. This subobjective arises from the fact that accrual-basis measures of the cost of government programs, functions, and activities may differ from the amounts used in the budget for a variety of valid reasons.

121. Reports primarily intended to address objective 1 and its first two subobjectives would use budgetary measurement. Subobjective 1C would use both budgetary and accrual measures because reconciliation of the two is implied. The basic accounting unit for this objective would be the budget account, although accounts are often aggregated for some reporting purposes.

Operating Performance

Objective 2

122. **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.**

123. This objective arises from a democratic government's duty to be accountable to its citizens for managing resources and providing services economically and efficiently and for effectiveness in attaining planned goals. Also, the government should be accountable for raising resources efficiently.

124. Because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure "earnings" or "net income" as would be done in business accounting. 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 relationship to a variety of measures of the achievement of results.

125. Certain subobjectives arise from the basic objective of reporting on operating performance, as discussed below.

<u>Federal financial reporting should provide information that helps the reader to determine:</u>

126. **2A.The costs of providing specific programs and activities and the composition of, and changes in, these costs.**

127. Examples of financial information that can help to address this objective include

- information on the costs of programs and activities;
- cost comparisons with estimates, with similar functions, with targets,[9] and over time; and

[9]"Performance targets" specify the level of performance that is set as a goal by policy and program officials. Targets may be set in terms of outputs, outcomes, impacts, cost per unit of output, etc.

- relevant analyses of the composition and behavior of costs, such as full and incremental costs, fixed and variable costs, direct and indirect costs, and reimbursable and other costs, where appropriate.

128. **2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.**

129. Examples of information that can help to address this objective include

- financial and nonfinancial indicators of service inputs, outputs, and outcomes, including comparisons with goals;
- indicators of program efficiency and effectiveness;
- work load measures and unit costs; and
- total and marginal costs and benefits, the relationship of these to budget requests, and when the benefits will be realized.

130. **2C.The efficiency and effectiveness of the government's management of its assets and liabilities.**

131. This subobjective implies concern with the management of all federal assets and liabilities used by or under the control of agencies. Users of financial reports focus on the use of these resources in program operations, not solely on their financial value. Reports intended to address this objective would provide information to help users assess the efficiency and effectiveness with which

- cash is used;
- loan, loan guarantee, and other receivables programs are conducted;
- inventories of supplies, materials, and similar items are maintained; and
- forfeited and other tangible assets are handled.

132. Other examples of information relevant to this objective might include

- the service life and replacement cost of major systems and equipment;
- backlogs (and budgetary impact) of delayed maintenance, rehabilitation cost or replacement value of assets;
- the market value of forfeited and other assets, particularly those held for sale;
- the extent of unpaid expenses; and
- estimates (and ranges of estimates) of other known liabilities (such as leases or deposit and other insurance liabilities) and other exposures to loss.

133. Further discussion of performance measurement and how financial reporting can contribute to reporting on performance is provided in Chapter 9.

Stewardship

Objective 3

134. **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.**[10]

135. This objective is based on the federal 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. Certain subobjectives arise from the basic objective of stewardship, as discussed below.

Federal financial reporting should provide information that helps the reader to determine:

136. **3A.Whether the government's financial position improved or deteriorated over the period.**

Examples of information relevant to this objective include

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations (such as the probable cost of deposit insurance).

137. Assessing whether the government's financial position improved or deteriorated over the period is important not only because it has financial implications but also because it has social and political implications. This is because analysis of why financial position improved or deteriorated helps to explain whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits. The latter notion is sometimes referred to as "interperiod equity."[11]

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[10]The concepts of "financial position" and "financial condition" are discussed in Chapter 8.

[11]In paragraph 61 of its first conceptual statement, *Objectives of Financial Reporting*, the GASB noted: "The Board believes that interperiod equity is a significant part of accountability and is fundamental to public administration. It therefore needs to be considered when establishing financial reporting objectives [for state and local governmental entities]. In short, financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided." GASB's Statement 11, *Measurement Focus and Basis of Accounting--Governmental Fund Operating Statements*, adds "Conversely, [a measure of interperiod equity] would show whether current-year revenues not only were sufficient to pay for current-year services, but also increased accumulated net resources."

138. Viewed in this broader context, providing information to meet objective 3 and its subobjectives will help to satisfy the needs expressed by financial report users. It will also help to explain the issuance of new debt in relation to expenditures for activities with current benefits versus expenditures for investment-type activities that yield future benefits.

139. **3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.**

140. Information about the results of past government operations is useful in assessing the stewardship exercised by the government. Users of financial reports also want help in assessing the likelihood that the government will continue to provide the current level of benefits and services to constituent groups, such as farmers, retirees, and the poor.

141. Information relevant to this objective may include disclosures of financial risks that are likely or reasonably possible from sources such as government-sponsored enterprises, deposit insurance, and disaster relief programs. It could also include information such as

- the long-term financial implications of the budgetary process,
- the status of trust funds, and
- backlogs of deferred maintenance.

142. Providing information of this kind may require the use of reporting mechanisms other than traditional financial statements. For example, special reports may have to be developed to demonstrate whether the level of a particular year’s maintenance and rehabilitation expenditures resulted in an improvement or a deterioration of capital assets and infrastructure.

143. **3C.Whether government operations have contributed to the nation’s current and future well-being.**

144. Objective 3, in general, and subobjective 3C, in particular, imply a concern with “financial condition,” as well as “financial position.” Financial condition is a broader and more forward-looking concept than that of financial position. Reporting on financial condition requires financial and nonfinancial information about the national economy and society, as well as about the government itself. For example, reports intended to help meet this objective might address users’ needs for information about

- investments in (or expenditures for) research and development, military readiness, and education;
- changes in the service potential of infrastructure assets;
- spending for consumption relative to investments;
- opportunities for growth-stimulating activities; and
- the likelihood of future inflation.

145. Indicators of financial position, measured on an accrual basis, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. For example, subobjective 3B might imply reporting, among other things, a current law budget projection under a range of alternative assumptions. Reports intended to achieve subobjective 3C might disclose, among other things, the contribution that the government is making to national wealth by financing assets that are not federally owned, such as research and development, education and training, and state-owned infrastructure. Information on trends in total national wealth and income is also important.

Systems And Control

Objective 4

146. **Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that**

- **transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with federal accounting standards;**
- **assets are properly safeguarded to deter fraud, waste, and abuse; and**
- **performance measurement information is adequately supported.**

147. This objective arises from the three preceding objectives, in conjunction with the fact that accounting supports both effective management and control of organizations and the process of reporting useful information. Indeed, accounting processes are an integral part of the management control system.

148. The ability to prepare financial reports that report all transactions, classified in appropriate ways that faithfully represent the underlying events, is itself an indication that certain essential controls are in place and operating effectively. The preparation of reliable financial reports also helps to ensure that reporting entities have early warning systems to indicate potential problems and take actions to correct material weaknesses or problems.

149. Sound controls over internal processes are essential both to safeguard assets and to ensure economy, efficiency, and effectiveness in many governmental programs.

150. Information relevant to this objective helps financial report users to determine whether the entity has established reasonable, cost-effective programs to safeguard assets, prevent and detect waste and abuse, and reduce error rates. An example of information that would

address this objective is management's assertion about the effectiveness of the internal accounting and operational control system.

Chapter 5: Balancing Costs And Benefits In Recommending Standards

151. Users' information needs define financial reporting. Even so, the process of articulating financial reporting objectives and then recommending accounting standards is not a simple progression from canvassing users of federal financial information to recommending standards. This is partly because such users, when asked about their information needs, may give answers that are limited by their past needs and experiences. More fundamentally, it is because articulating objectives and recommending accounting standards necessarily involve judgments about the costs and benefits of producing more information or of reporting it differently.

152. The standard-setting process is further complicated by the fact that any given accounting standard can have many different kinds of effects that must be considered. For example, accounting standards can influence the activities of agency accountants and the auditors who review reports prepared by those accountants, as well as the decisions of those who read the financial statements. Thus, a standard may influence which physical assets are under accounting control and the extent of work the auditor does to provide assurance about those assets. The accountants' and auditors' reports, in turn, may influence various decisionmakers in different ways as they select policies regarding the assets and the systems used to control them, decide how to implement the policies, and evaluate the results.

153. The standard setter must, to some extent, be aware of these potential effects when considering the costs and benefits of any given accounting alternative. As an added complication, *the same piece of information* may be used in different ways for different decisions. In other words, there are different kinds of "use." In some cases, the information may be consciously used in well-defined ways; in other cases, it may subtly influence the way people see the world, understand their options, and assess their priorities.

154. For example, the size of the deficit may have a very specific meaning with quite explicit implications (e.g., sequestration) under certain rules for scoring the budget. The deficit may also influence the economy because it affects aggregate demand and the government's financing requirements in a variety of ways that economists can only partially explain and quantify. Finally, the deficit may influence people's perceptions of their own well-being or of the nation's financial condition in more subjective or symbolic ways that can affect both private and collective behavior (e.g., willingness to undertake various new commitments, to pay more in taxes, or to accept reductions in program benefits).

155. Finally, as noted earlier, accounting and financial reporting cannot satisfy every need for information and accountability. For many purposes, other information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective. This constraint pervades any discussion of the objectives of federal financial reporting.

Chapter 6: Qualitative Characteristics Of Information In Financial Reports

156. Financial reporting is the means of communicating with those who use financial information. For this communication to be effective, information in financial reports must have these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.[12]

Understandability

157. Special purpose reports are prepared to meet the needs of specified users. Understandability is rarely a problem in such cases because mutual understanding of what information is needed can generally be assumed between report preparer and report user. Information in general purpose financial reports, however, should be expressed as simply as possible. Users of general purpose financial reports, including internal users, tend to have different levels of knowledge and sophistication about government operations, accounting, and finance.

158. To be publicly accountable, the federal government and its component entities should issue general purpose financial reports that can be understood by those who may not have a detailed knowledge of accounting principles. Those reports should include explanations and interpretations to help report users understand the information in the proper context. However, 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.

159. For reports to be understandable to different audiences, different reports may be necessary to provide information relevant to the needs of the expected report users, with suitable amounts of detail, explanation, and related narrative. To be fully intelligible, financial information in general purpose reports may need to be presented in relation to the goals, service efforts, and accomplishments of the reporting entity.

[12]For the most part, these characteristics are similar to those described by the FASB and the GASB.

Reliability

160. 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 represent faithfully the underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the intended report user. Reliability 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. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.

Relevance

161. Relevance encompasses many of the other characteristics. For example, if the information provided in a financial report is not timely or reliable, it is not relevant. Information can, however, meet all other characteristics and still not be relevant. To be relevant, a logical relationship must exist between the information provided and the purpose for which it is needed. Information is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event. Relevance depends on the types of financial information needed by the various users to make decisions and to assess accountability.

Timeliness

162. In some circumstances, the mere knowledge that a report eventually will be made public can influence behavior in desirable ways, just as the knowledge that one's tax return might eventually be audited can influence the behavior of people when they report their income. In other circumstances, however, if financial reports are to be useful, they must be issued soon enough to affect decisions. Timeliness alone does not make information useful, but the passage of time usually diminishes the usefulness that the information otherwise would have had. In some instances, timeliness may be so essential that it requires sacrificing a certain amount of precision or detail; a timely estimate may then be more useful than precise information that takes longer to produce.

Consistency

163. Financial reports should be consistent over time; that is, once an accounting principle or reporting method is adopted, it should be used for all similar transactions and events unless there is good cause to change. The concept of consistency in financial reporting extends to many areas, such as valuation methods, basis of accounting, and determination of the financial reporting entity. If accounting principles have changed or if the financial reporting entity has changed, the nature and reason for the change, as well as the effect of the change, should be disclosed.

Comparability

164. Financial reporting should help report users make relevant comparisons among similar federal reporting units, such as comparisons of the costs of specific functions or activities. Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices.

Chapter 7: Materiality

164a. A reporting entity considers materiality in the application of accounting and reporting requirements. The Federal Accounting Standards Advisory Board (FASAB or "the Board") intends that information presented in accordance with generally accepted accounting principles (GAAP)[12.1] will not contain misstatements, including omissions of information, considered material. Such omissions include information that is necessary for a reasonable financial report user (reasonable user)[12.2] to understand the effect of particular material transactions, events, and conditions on the entity's financial statements, notes to the financial statements, and required supplementary information.

[footnote] 12.1 Such information would include financial statements, notes to the financial statements, and required supplementary information.

[footnote] 12.2. A reasonable financial report user has appropriate knowledge of the federal government's activities and reviews and analyzes the information diligently.

164b. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information.

164c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

164d. Misstatements should be considered individually and in the aggregate. Materiality determinations regarding such misstatements should include consideration of both qualitative and quantitative factors. Information that is not considered quantitatively material may be considered qualitatively material if it can reasonably be expected to change or influence the judgment of a reasonable user. Qualitative considerations include the public accountability[12.3] of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of government programs, activities, and functions; as well as other factors that may affect a reasonable user's judgment about the information.

[footnote] 12.3. SFFAC 1, par. 73 and 74 identify different kinds of accountability. These may be relevant qualitative considerations in determining materiality.

164e. Materiality concepts and related factors should be considered when making materiality judgments. While specific qualitative and quantitative thresholds for materiality are not provided in this Statement, illustrative factors are discussed in paragraphs 164c and 164d.

164f. In applying materiality concepts, the specific needs of a reasonable user should be considered. In the federal government environment, such needs generally differ from those of the commercial entity financial report user. For example, due to the visibility and sensitivity of government programs, the needs of federal government financial report users extend to having the ability to assess the allocation and use of resources in the federal government. Compliance with laws, regulations, contracts, and grant agreements is also a significant consideration of the user.[12.4]

[footnote] 12.4 Information requiring protection from unauthorized disclosure is referred to as "classified national security information." The application of federal financial accounting standards needs to support the legal requirements to protect classified national security information.

164g. To emphasize that materiality should be considered in applying the accounting standards, the Board will place the following notice at the end of each Statement of Federal Financial Accounting Standards (SFFAS):

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. *[footnote]*

[footnote]: Refer to Statement of Federal Financial Accounting Concepts 1, Objectives of Federal Financial Reporting, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.

Chapter 8: How Accounting Supports Federal Financial Reporting

165. This Chapter explains the focus of the FASAB's concern by showing how accounting supports financial reporting and thus how accounting standards recommended by the FASAB can influence federal financial reporting. This Chapter shows how the FASAB's recommendations can influence a wide variety of financial reports. Additionally, it lays a foundation for the discussion (in Chapter 9) of how financial reporting in general, and cost information in particular, contribute to performance reporting. In effect, Chapter 8 outlines parts of a conceptual framework for federal accounting but is limited to those ideas, such as "financial position" and "financial condition," that will help readers understand the Board's proposed statement of objectives for federal financial reporting.

Financial Core Data

166. The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or promises to provide them. These may involve flows of economic goods, cash, or promises. These comprise the "core" data of the accounting discipline. This initial step in the accounting process is depicted at the bottom of figure 1, in the box numbered 1. To enhance the usefulness of this core set of data about transactions with other entities, accountants make various accruals, classifications, interpretations, etc.

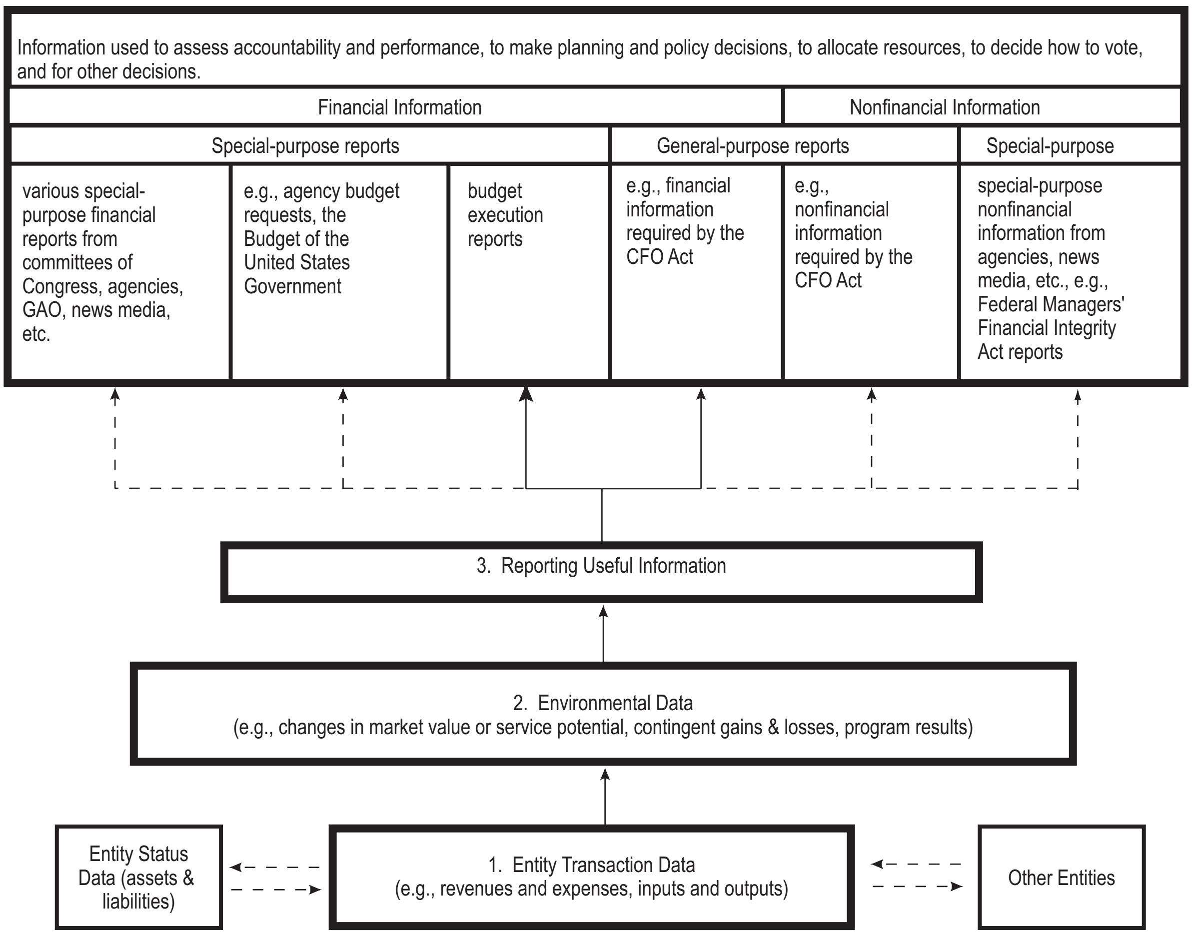
167. Many accounting entries recorded in the accountant's general ledger data base are such rearrangements of data about previously recorded transactions with other entities rather than new transactions involving flows of resources or promises between entities.[13]

168. In the branch of accounting called financial accounting, the most noteworthy interpretations or classifications are those about which data pertain to the past and which pertain to the future. In other words, financial accounting is largely concerned with assigning the value of past transactions to appropriate time periods.

169. Transaction data assigned to a period that has elapsed are said to be "recognized" in the statement of operations (or income statement), e.g., as an expense or a revenue of that period. Transaction data pertaining to the future are recognized in the statement of financial position (or balance sheet) as assets and liabilities.

[13]See William J. Schrader, Robert E. Malcom, and John J. Willingham, "A Partitioned Events View of Financial Reporting," *Accounting Horizons* (Dec. 1988), p 10-20. For a more academic exploration of the ideas involved, see Yuji Ijiri, "Theory of Accounting Measurement," S*tudies in Accounting Research #10*, American Accounting Association (1975).

Figure 1: How Accounting Contributes to Information Used by Citizens, Congress, Federal Exceutives, and Program Managers



170. Together with the statement of cash flows, the income statement (or statement of operations or activities) and the balance sheet comprise the three “basic” general purpose financial statements for privately owned entities. Other statements, such as a comparison of actual results with the budget, may be regarded as part of the basic statements for governmental entities.

171. At the initial stage of the accounting process, the information about assets and liabilities is merely the result of assigning all or part of the value of certain transactions to the future. “Assets” and “liabilities” at this stage are *not* statements about future benefits or sacrifices that can be proven or disproven. They are allocations of the cost of past transactions based on assumptions about future benefit and sacrifice.

172. This has been a common source of confusion when accountants communicate with nonaccountants, for whom the word “asset” typically implies something of value that can be sold or used. Much of the evolution of accounting under the FASB and the GASB has been to reduce this confusion, to improve communication, and to make financial reports more faithfully represent economic reality in terms meaningful to report users. This evolution has involved adding increasing amounts of information to the core set of transaction data. That process is discussed later.

173. In other words, the amount of “equity” or “net assets” based on the core data in a bookkeeper’s trial balance is not a direct *measure* of either the market value or the service potential of the entity. In some circumstances, however, net assets can be a meaningful *indicator* of that value or potential. (The word “indicator” is used deliberately to avoid the implication of precision that may be associated with the word “measure.”)[14]

174. Accounting data may be further assigned, allocated, or associated with units of activity or production, segments of organizations, etc., *within the same time period*. These kinds of *intraperiod* allocations are developed most extensively in the branch of accounting called cost or managerial accounting. Neither the FASB nor the GASB has devoted much attention to this branch of accounting, but the FASAB, because of its unique mission, will need to do so. One reason for performing cost accounting is to assist in performance measurement.

[14]The term “measure” is commonly used in accounting literature regarding cost and in other literature (including the GASB’s) regarding performance. This document follows that practice. In a conceptual discussion, however, it is important to note that “cost,” “performance,” and “financial condition” are all multidimensional concepts. It may be more precise to think in terms of multiple indicators that provide information about these concepts instead of a single-valued “measure” of any of them.

Nonfinancial Core Data

175. Traditionally, financial accountants record and describe transactions in terms of money. At the most detailed level, however, their records usually include information about the associated physical inputs and outputs of goods, labor, etc. This nonfinancial information is an important part of the data available for reporting and evaluating the economy and efficiency of the organization’s performance.

Budgetary Core Data

176. In government the data on transactions with other entities include information on the budget authority, obligations, outlays, receipts, and offsetting collections for the transactions. This information is maintained in what are called budgetary accounts to distinguish them from the “proprietary” accounts that record other information on transactions. The budgetary and proprietary accounts at this level are said to be “integrated.” In effect, they maintain information about different stages of a transaction.

Financial Environmental Data And The Concept Of Financial Position

177. The core set of accounting data is expanded with a variety of what may be called “environmental” data to distinguish them from the data that arise from transactions (flows of resources or promises) with other entities. Box 2 in figure 1 depicts this step of the accounting and reporting process. Many events within the environment of a reporting entity may have economic consequences for the entity. Examples of environmental data that may be relevant to financial reporting for some purposes include current market prices, net realizable values, changes in discount (interest) rates, and impairment of assets (either in terms of market value or in terms of service potential). Judgments about what environmental data should be added are made by considering the specific information needed for specific purposes.

178. At this level of the accounting and financial reporting process, the information reported in the balance sheet transcends bookkeeping. It can now represent more of what is known about future economic benefits and sacrifices. To the extent that this is accomplished, the balance sheet may be said to represent the “financial position” of the reporting entity. The concept of financial position is that of a point-in-time snapshot of an entity’s economic resources and the claims on those resources.

Nonfinancial Environmental Information

179. Nonfinancial information about program efforts, accomplishments, and outcomes may be collected and associated with the financial environmental data. This information is particularly important for governments because there is no direct analogue to “net income” or “earnings” to gauge the economy, efficiency, and effectiveness or net value of governmental activity.

The Concept Of Financial Condition

180. As more environmental data are added to the core data, a concept that is broader and more forward-looking than “financial position” emerges. That concept is “financial condition.” For the U.S. government, the additional data could include financial and nonfinancial information about current conditions and reasonable expectations regarding the national and even the global society. For example, the expected implications of environmental degradation; the relative competitiveness and productivity of the U.S. economy; or expected changes in the population’s composition in terms of age, gender, longevity, education, health, and income all might affect judgments about the government’s financial condition.

181. Information about financial condition can be conveyed in a variety of schedules, notes, projections, and narrative disclosures. Among the most important of these is management’s “discussion and analysis” of known trends, demands, commitments, events, and uncertainties. For federal reporting entities, management’s discussion and analysis might address such topics as

- budgetary compliance;
- internal control systems;
- capital resources and investments;
- service efforts, accomplishments, and results of operations; and

- the reasonably possible future impact of known trends, risks, demands, commitments, events, or uncertainties that may affect future operations.[15]

182. Increasingly, managers and investors in the private sector are attending to other factors that may sometimes be useful indicators of an entity's financial condition, including such intangible factors as the quality of the entity's

- information and analysis capabilities,
- strategic planning,
- human resource development and management, and
- constituent satisfaction.

Similar factors may be relevant for many federal reporting entities.

Kinds Of Financial Information Needed And Provided

183. The information produced by these accounting processes supports the overall reporting process. Traditionally, the items of information included in financial statements are classified in various "elements" of financial reporting, such as "assets," "liabilities," "revenues," or "expenses." In future projects, the FASAB may consider the definition of elements of federal financial reporting. For the purposes of this Statement of Concepts, however, it is not necessary to do so. It is sufficient to note that needed financial information identified by some current and potential users of federal financial reports can be classified under six broad headings:

- information on the sources and uses of budgetary resources,
- information about operations and the related resources,
- information about the government's assets,
- information about the government's liabilities and financial responsibilities,
- information that addresses concerns with the future, and
- Information that discloses the levels of financial controls.

184. Examples and further discussion of such information needs are provided in appendix B.

[15] Such a discussion and analysis is required in federal financial reports prepared pursuant to the CFO Act of 1990. In these reports, the discussion and analysis is referred to as the "overview" section. OMB Bulletin 92-03 provides guidance on preparing the overview section.

How This Information Flows Into Financial Reports

185. The core and environmental financial information, often supplemented with information from other sources, is the basis for a variety of general purpose and special purpose reports. For this reason, figure 1 culminates with the preparation of useful reports. A direct relationship exists between the accounting and reporting processes both for *general purpose* financial reports and for *budget execution* reports. The dotted line in figure 1 leading to other kinds of reports emphasizes that other kinds of information are often more heavily involved in producing them. Accounting contributes to these reports but has less influence over the nature, scope, and content of them. (Appendix C lists selected federal reports that are regularly prepared.)

Relationship Of Financial Reporting To Budgeting

186. “The budget” is a broad term that may include, among other things, a projection of spending authorities and means of financing them for a future period and a report of the actual spending and associated financing for a past period. The FASAB’s recommendations may influence the reporting of actual budgetary data.

187. The Budget of the United States Government is the most widely recognized and used financial report of the federal government. The budget process is the government’s principal mechanism for reaching agreement on goals, for allocating resources among competing uses, and for assessing the government’s fiscal effects on economic stability and growth. Most attention is paid to these future-oriented roles of the budget.

188. Budget execution is designed to control and track tax receipts and the use of resources according to the purposes for which budget authority was approved. Actual receipts, obligations, and outlays are recorded by account, as is the status of budgetary resources at the end of each fiscal year.

189. Budgetary measurement is designed to assist in the control and allocation of resources by showing the cash outlays implied by each decision when the decision is made. In some cases, the budget now also includes accruals for costs in advance of the required cash outlay. Budgetary concepts are under continual review. They may be changed by law or, after consultation with the Congress, in the annual revision of OMB Circular A-11, “Preparation and Submission of Budget Estimates.”

190. The Board’s authority does not extend to recommending budgetary standards or budgetary concepts, but the Board is committed to providing reliable accounting

information that supports budget planning and formulation. The Board also supports efforts to ensure the accuracy and reliability of reporting on the budget.

191. The Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a variety of measures of costs and other information that complements the information available in the budget. Together with budgetary reports, these reports will provide a more comprehensive and insightful understanding of the government's financial position, results of operations, and financial condition than either set of reports alone.

Chapter 9: How Financial Reporting Supports Reporting On Operating Performance

192. The second objective and its subobjectives concern reporting on performance. References to measuring cost pervade this objective and its supporting narrative. The topics of cost and performance measurement are related because it is by associating cost with activities or "cost objectives" that accounting can make much of its contribution to reporting on performance.

193. Setting performance targets is a function of management, not of accountants. That is, elected and appointed officials, including both program and policy officials, decide what the government will do, how much the government will do, and how it will be done. These officials consider the relevant constraints and other factors when establishing the performance targets. Measuring performance against those goals is an essential part of management. On the other hand, measuring cost is an important part of measuring performance, and measuring cost and reporting the results is a function of accounting and the financial reporting system. Financial reporting standards deal with what information is reported and how it is reported, not with the target levels of performance.

194. This Chapter first discusses cost measurement in general terms, then outlines a framework for reporting on performance to show how cost information can assist in that endeavor. Both cost measurement and performance measurement are complex subjects. Difficult problems arise during attempts to implement the ideas involved. For example, meaningful interpretation may require disaggregation of information, or adjustment of targets for differences in client characteristics, for local conditions, and for other factors beyond the government's control. Such problems are beyond the scope of this conceptual document. This Statement does not purport to present a comprehensive discussion of how to measure cost or performance. Neither does this Statement address the problems of

implementation; it merely shows the relationship between financial reporting and performance reporting in conceptual terms.

Cost Measurement

195. As used in this Statement of Concepts, “cost” is the monetary value of the resources used. Thus far, the FASAB has considered the recognition and measurement of certain assets and liabilities that could influence the amount of cost recognized in a given period by a federal reporting entity. For example, the Board’s Statement on *Accounting for Direct Loans and Loan Guarantees* implements accrual accounting for these programs, similar to the accrual budgeting mandated for them by the Credit Reform Act of 1990.

196. A “cost objective” is a program, a function, an activity, an organizational subdivision, a contract, or another work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capital projects, etc. The basic premise of cost accounting has been described by saying that the measurement, assignment, and allocation of costs to cost objectives should be based on the beneficial or causal relationship between those costs and the cost objectives. In defining the proper measurement, assignment, and allocation of cost for a given purpose, selecting the appropriate accounting method and whether to use full costing should be carefully considered.

Method of Accounting

197. The accrual basis of accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated.

Full Costing

198. Full assignment of all costs of a period, including general and administrative expenses and all other indirect costs, is an important basis for measuring cost of service. However, full cost is not necessarily the relevant cost for making all decisions. For example, incremental cost is more appropriate for many kinds of decisions, while opportunity cost is more appropriate for others. Similarly, cost that is controllable at a given management level is more appropriate for most evaluations of the performance of those managers. Accordingly, accounting systems should permit the calculation of the relevant costs needed for a range of decisions, as determined by the specific situation, and financial reports should reflect costs suitable to the purpose intended.

Performance Measurement

199. Performance reporting is broader than financial reporting, but good financial reporting is essential to support performance reporting. The GASB has identified three broad categories of measures for reporting on performance of state and local governmental entities: those that measure service efforts, those that measure service accomplishments, and those that relate efforts to accomplishments. Although some performance measures may not be clearly assignable to one of these categories, the categories are helpful for understanding how and where financial reporting can *contribute to* performance reporting by providing relevant financial information.

200. To clarify this relationship, the FASAB may wish to change or expand parts of the following discussion in future projects. At this time, however, the FASAB believes this basic framework is appropriate for the limited purpose of explaining how financial reporting can contribute to performance reporting.[16]

Measures of Efforts

201. Efforts are the amount of financial and nonfinancial resources (in terms of money, material, and so forth) that are put into a program or a process. Measures of service efforts also include ratios that compare financial resources with other measures that may indicate potential demand for services, such as the number of potential service recipients.

202. **Financial information** includes financial measures of resources used. They include the cost of salaries, employee benefits, materials and supplies, contract services, equipment, etc., used in providing a service. The FASAB's exposure draft (ED) on *Accounting for Inventory and Related Property* is an example of how the FASAB's recommendations could affect information reported on resources used.

203. **Nonfinancial information** includes the following:

- Number of personnel: Because personnel are a major resource for many federal agencies and programs, indicators that measure the number of full-time equivalent employees or employee-hours used in providing a service often provide a significant measure of resources used.
- Other measures: These may include the amount of equipment (such as number of vehicles) or other capital assets used in providing a service. Because some federal

[16]The following discussion is based largely on the GASB's *Preliminary Views on Service Efforts and Accomplishments Reporting*, December, 1992.

programs use large amounts of capital assets, measures of the use of such assets can be important indicators of resources used.

Measures of Accomplishments

204. Measures of accomplishments report what was provided and achieved with the resources used. There are two types of measures of accomplishments—outputs and outcomes. Outputs measure the quantity of services provided. Outcomes measure the results of providing those outputs. For some kinds of programs, financial information can provide measures of accomplishments. For example, for some government business-type activities, just as for profit-seeking businesses, the revenue earned can be used as an indicator of accomplishments. In most government programs, however, the important indicators of accomplishments are based on nonfinancial information, as discussed below.

205. **Outputs**, which can be measured in these ways:

- Quantity of service provided: These indicators measure the physical quantity of a service provided.
- Quantity of a service provided that meets a certain quality requirement: These indicators measure the physical quantity of a service provided that meets a specified criterion or a set of criteria. (Quality requirements can also be defined and measured regarding inputs.)

206. **Outcomes**, for which indicators measure accomplishments or results that occur (at least partially) because of the service efforts. Some authorities use terms like “impact,” “effect,” or “results” to distinguish the change in outcomes specifically caused by the governmental activity from the total change in outcomes that can be caused by many factors. Though it is not always feasible, in theory performance evaluation should focus on results or effects in the sense of impacts, i.e., on the differences between program outcomes and the outcomes that would have occurred in the absence of the program. Results also include measures of public perceptions of outcomes.

207. Outcome measures are particularly useful when presented as comparisons with previous years, established targets, goals and objectives, generally accepted norms and standards (in the sense of “targets”), other parts of the entity, or other comparable entities.

208. Sometimes, the secondary and/or unintended effects of a service on the service recipients, community, or nation can be identified and may warrant reporting.

Measures That Relate Efforts to Accomplishments

209. For profit-seeking entities and for some business-type government programs, the amount of net income can be thought of as a single indicator that relates organizational efforts to accomplishments. For most government activities, however, relating efforts with accomplishments in a meaningful manner is more complex. Two types of such indicators are discussed below.

- Efficiency measures that relate efforts to outputs of services: These indicators measure the financial resources used or the cost (in dollars, employee-hours, or equipment) per unit of output. They provide information about the production of an output at a given level of resource use and demonstrate an entity's relative efficiency when compared with previous results, established goals and objectives, generally accepted norms or targets, or results achieved by similar entities.
- Effectiveness or cost-outcome measures that relate efforts to the outcomes or results of services: These measures report the cost per unit of outcome or result. They relate costs and results to help managers, executives, Congress, and citizens assess the value of the services provided by an entity.

210. As is evident, financial or cost information is an important component of both types of measures that attempt to relate efforts to accomplishments.

Limitations of Performance Measurement

211. Performance measurement is an essential part of good management, and performance reporting is an essential part of government accountability. Important limitations and difficulties associated with performance measurement and reporting should be noted, although they cannot be fully explored in a brief outline of the subject such as this. For example, performance usually cannot be fully described by a single measure, indicators of service efforts and accomplishments do not, by themselves, indicate why performance is at the level reported, and reporting quantifiable indicators can sometimes have unintended consequences.

212. For these and other reasons, the three categories of performance measures generally need to be accompanied by suitable explanatory information. Indeed, narrative information is an essential part of reporting on performance. Explanatory information includes both quantitative and narrative information to help report users understand reported measures, assess the reporting entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance. (As noted, the reporting entity may be the federal government as a whole or any of its component reporting entities.) Explanatory information can include, for example, information about factors substantially

outside the entity's control, as well as information about factors over which the entity has significant control.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Introduction

213. This appendix summarizes some of the considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and for rejecting others. Individual Board members gave greater weight to some factors than to others.

214. The Board used several methods to arrive at the knowledge base and conclusions that shape this Statement. Its staff conducted focus group discussions, interviewed users and preparers of financial information, and performed other research.

215. Based on this work, the Board published an exposure draft on January 8, 1993, as called for by the Board's rules of procedure. Forty-six letters were received in response. The Board also held a public hearing on the exposure draft on April 21-22, 1993, at which it received valuable comments.

216. The Board wishes to thank everyone who participated in the process.

Relationship Between Financial Reporting And The Budget

217. The Board considered whether it should modify the exposure draft's discussion of the relationship between financial reporting and the budget. Several respondents commented on this subject, but often in different ways. Some alluded to budgetary and proprietary (or "accrual" or "financial") accounting in a context that implied each should be on a different basis but reported in an integrated fashion. Others suggested that using the same basis for reporting and for budgeting was essential to achieve the objectives stated for federal financial reporting.

218. Many recommendations have been made over the years that information on expenditures be arranged to permit better perception of the relationship between the expenditures and

national policy objectives. Some of those recommendations have related to the budget. Some have called for an “accrual-basis” budget. Those who would like to change the organization and/or the basis of the budget, e.g., to more of a “program” organization or to more of an “accrual” basis, might regard financial reporting from a program perspective and/or on an accrual basis as a valuable first step before considering restructuring the budget.

219. Others may have fundamentally different views. For example, some believe there is merit in maintaining a distinction between accrual accounting and budgeting, except to the extent that those involved in preparing and approving the budget elect to use an accrual convention, as in the Credit Reform Act of I990. These persons believe that the budgetary basis of measurement should, in principle, sometimes be different from the accrual basis. They infer this from the different purposes of budgeting and financial reporting.

220. The Board concluded that there was no reason to change the discussion of this topic in this Statement, because the Board has no jurisdiction regarding the budget.

State And Local Governments And Other Nonfederal Entities

221. Some respondents expressed concern about the potential impact of federal accounting standards on state and local governmental accounting. These respondents would like to minimize the cost of compliance with federal requirements. To the extent possible, they would like to avoid the need to report on a basis different from that specified by the GASB. Presumably their comments dealt with general purpose reporting because grantees must now prepare various special purpose reports pursuant to the requirements of granting agencies, OMB, the Single Audit Act, etc.

222. The FASAB has no intent to recommend standards for general purpose external financial reporting by nonfederal entities. The FASAB’s mission is to consider and recommend accounting principles for the federal government. The FASAB’s work, therefore, will have no direct effect on nonfederal entities. It is true, however, that the FASAB’s recommendations could eventually result in increased demand for information from recipients of federal funds. This could happen when such information was necessary for federal reporting entities to achieve the stated objectives of federal financial reporting. Such requirements would be “special purpose” reporting requirements, from the perspective of grant and contract recipients.

223. These requirements most likely would be imposed by program officials in contracts and grant agreements with the recipients of the federal funds. The Board acknowledges that the federal government has a responsibility to consider the cost imposed on nonfederal

entities when making decisions to impose such requirements. At the same time, benefits to all entities and to all citizens involved also must be considered.

Reporting On Performance And Using Nonfinancial Information

224. Most respondents who addressed reporting on performance supported the exposure draft, but some thought the language was too encompassing. The Board concluded that their concern was stimulated in part by the wording of the first three objectives in the exposure draft. Each began with the phrase “federal financial reporting should assist...” However, each of these objectives subsequently included a phrase “Federal financial reporting should enable the reader to determine...” that perhaps implied more than the Board intended.

225. Accordingly, the Board substituted the phrase “provide information that helps the reader...” for “enable...” The Board also made certain other changes recommended by some respondents. In particular, the Statement now uses the phrase “performance target” to refer to desired levels of performance defined by elected and appointed officials. This term is used instead of “performance standard” to avoid possible confusion with “financial reporting standards,” which deal with what information is to be reported in designated reports and with how it is reported.

226. The Statement also makes it clear that performance targets should be set by program and policy officials working together. Financial officials have a role to play in this process, especially where financial data are involved. That role is based on their expertise in cost measurement and their responsibility to ensure the integrity of the data.

227. One authority on public administration has explained the relationship in this way:

> Government accountants are responsible in part for capturing, reporting, and analyzing actual financial information important for both policy making and management. Policy analysts and budget professionals deal primarily with what should occur and accountants deal primarily with capturing and recording what did occur. In addition, government accountants have auditors reviewing their work professionally to further ensure the integrity of the accounting process.[17]

228. The Board believes that accounting supports financial reporting and that, in the government, financial reporting goes hand in hand with accountability and performance

[17]Thomas D. Lynch, “President’s Column,” ASPA Times, vol. 16, No. 6 (June 1, 1993), p. 5.

evaluation. Financial accounting and financial reporting have a special role in assuring compliance with finance-related requirements for transactions. This is most directly relevant to objectives 1 and 4.

229. Financial reporting, however, also provides useful information about costs, assets, and liabilities. This information is especially relevant to objectives 2 and 3. Routine reporting of outputs, outcomes, and their costs is an important part of a performance monitoring system. Assessments of impacts (also referred to as effects, or results) specifically caused by governmental action are more likely to be performed in less-frequent program evaluations and special studies. Those studies draw upon the output, outcome, and cost information that is (or should be) more frequently published.

230. Federal accounting and financial reporting exist within the context of various laws intended to foster accountability and performance evaluation. Neither the FASAB nor federal financial reporting can independently accomplish the objectives of evaluating performance or assuring accountability, but they can contribute to achieving them. Furthermore, to make their essential contribution to these ends, accountants, auditors, and financial managers must understand the overall framework for achieving these objectives.

231. For nongovernmental entities, competitive markets for goods, services, and capital provide an independent assessment of the economy, efficiency, and effectiveness with which those entities use resources to meet their customers' needs. There is no similar proof of value for federal output independent of the political process. To report on the results of operations of a governmental entity, nonfinancial information is essential, in conjunction with financial information.

232. In concept, this fact could imply that a complete financial report of a federal reporting entity should include indicators of economy, efficiency, and cost effectiveness if the report is to fairly present the entity's financial position and results of operations. Paragraph 164 notes that financial or cost information is an important component of both types of measures that attempt to relate efforts to accomplishments. In practice, the extent to which it is feasible and cost effective to present such information can be decided only after careful study of the specific circumstances.

233. While specific decisions will require further study, the Board notes its belief that any attempt to demonstrate accountability beyond probity (level 5) and process (level 4) requires performance measures.[18] The Board's user needs study, its public hearings, and similar sources of information suggest a widespread belief that the federal government needs to make a more systematic attempt to measure and report outputs, outcomes

[18]Levels of accountability are discussed in Chapter 3.

(including impacts), and the costs of producing them. To do this, the Board believes, accounting and financial reporting play an essential part throughout the cycle of planning, budgeting, financial management, and evaluation of federal activities.

Stewardship

234. A few respondents said that the stewardship objective described in the exposure draft was too broad. They felt that information on the effects on the nation of policy decisions was outside the scope of federal financial reporting. The Board concluded that this concern—like the preceding one regarding reporting on performance--stemmed in part from the wording and structure of the first three objectives in the exposure draft.

235. Accordingly, the Board substituted the phrase “provide information that helps . . .” for “enable . . .” As noted earlier, federal financial reporting cannot by itself accomplish the objectives of evaluating or assuring stewardship; it can only contribute to those goals.

236. The Board notes that the federal government has two levels of stewardship. One is for its own assets and liabilities and its ongoing ability to operate. The other is its constitutional responsibility for the nation’s wealth and well-being. It is unique in this respect. If the nation’s wealth and well-being are deteriorating, the government’s financial condition is, or soon will be, deteriorating also—and vice versa. The financial condition of a sovereign national government and that of the nation itself are inextricably intertwined. Some information about the overall context must be provided, therefore, when reporting on the government as a whole, and perhaps when reporting on selected programs. As explained in Chapter 1, the FASAB does not recommend standards for economic reporting, but it may consider whether such information should be included in certain financial reports.

Systems And Control

237. Most respondents who addressed the fourth objective, originally titled “Deterring Fraud Waste and Abuse,” supported the exposure draft, though some suggested that it could be phrased in a more positive fashion. Several emphasized the need for this objective and for standards to achieve it, but a few thought that internal control should not be regarded as an element of financial reporting. Others suggested that a separate objective on this topic was not necessary because it could be inferred from the other objectives.

238. The Board agreed that the objective should be stated in more positive terms. Accordingly, it replaced “Deterring Fraud, Waste, and Abuse” with the new heading “Systems and Control” and made other changes in wording the objective. With regard to the fundamental

point, however, the Board continues to believe that systems and control are topics of sufficient importance and relevance to warrant addressing in their own right.

239. The Board's user needs study, public hearings, and other sources of information make abundantly clear that users want assurance that reported information is credible and reliable. They also want to know that reasonable controls are in place to deter fraud, waste, and abuse. Independent audit can help provide this assurance, but whether information is audited or not, effective systems and controls are essential to providing such assurance in a cost-effective way. Furthermore, effective systems and controls are essential to achieving the other objectives.

240. Perhaps the unique contribution of accounting-based reports for objectives 1 and 4 is the "core" accounting data base on transactions, especially on controlled transactions subject to finance-related restrictions. Systems of accounting control are integral parts of this special role for financial reporting. Similarly, regarding objective 2 and, to some extent, objective 3, systems and controls are important because direct observation of outcomes and impacts is often infeasible or expensive. In these cases, reliance on accounting and administrative controls to ensure compliance with good practices and processes is often a cost-effective surrogate for trying to measure the value added by governmental activities.

241. Finally, the fundamental notion of accountability pervades the entire set of objectives. Effective systems and controls are essential prerequisites to accountable government. Thus, the Board regards systems and controls as an integral part of accounting, accountability, and financial reporting.

Dual Focus On Internal And External Users

242. Several respondents mentioned users, but no consensus about a change to the exposure draft was evident. For example, some respondents urged greater emphasis on the information needs of external users or on objectives of general purpose, external financial reporting. Others urged greater emphasis on information needs of lower-level program managers and employees. These comments are not necessarily contradictory, nor are the competing perspectives necessarily mutually exclusive. The Board continues to believe that it must consider both external and internal users. The Board itself is the agent of officials who, in turn, are agents of the public. This organizational fact contributes to the dual focus.

243. Also, as noted in Chapter 1, the distinction between internal and external users is not clear for the federal government. Except in degree of detail, virtually all federal financial information is of interest to at least some segments of the public.

244. The Board acknowledges that this dual focus will often create the need to balance various considerations to arrive at an optimal result. For example, as one respondent properly noted, there could be a danger of emphasizing what he termed “comparable consistency” for uniform reporting to users who want comparable information across agencies. He was concerned that this might interfere with “relevant customization” of information systems to meet the unique needs of agencies in response to their specific environments. It is understood that “comparable consistency” of information is needed for some purposes and “relevant customization” for others.

245. The Board is primarily concerned with the former class of uses and reports, i.e., with ensuring the provision of comparable data where it is relevant and cost-effective to do so. Individual preparers often are not in a good position to judge the cost-benefit ratio of such information governmentwide. They are aware of the costs they incur to produce information, but they often are not aware of the potential benefit of producing that information. Neither are they in a position to establish standards that would produce such information.

246. On the other hand, there should be less need for outsiders like the Board or its sponsors to mandate relevant customization within agencies. Presumably each preparer can and will take care of that, provided that resources are available to do so and that there are no bureaucratic impediments.

247. In *concept*, therefore, there need be no conflict between “comparable consistency” and “relevant customization.” Furthermore, in *theory*, properly designed accounting systems should facilitate both internal and external reporting. In *practice*, however, because administrative resources for information processing systems are limited and because new systems take time to install, externally-imposed requirements for comparable consistency could compete with addressing internally perceived needs for relevant customization. The Board acknowledges this trade-off. This is just one of many cost-benefit factors that the Board will need to consider as it addresses each specific issue in subsequent projects.

Objectives For Governmentwide And Component Entity Reports

248. Some respondents suggested there should be separate sets of objectives for governmentwide and component entity reports. Similarly, it might also be possible to distinguish objectives for reporting by organizational unit components from those for functional or program components. Alternatively, one might imagine separate sets of objectives for reports to different audiences. The Board concluded that different reports are likely to emphasize different objectives but that there is no need to prepare separate statements of objectives. The Board will give due consideration to variations in emphasis among the objectives for different types of reports in subsequent statements and projects.

Appendix B: Users' Information Needs Addressed By Federal Financial Reporting

249. This appendix is consistent with Chapter 3's discussion of users' needs for financial information. It represents an intermediate step in the Board's consideration of the financial reporting objectives implied by those needs. The appendix is included to aid the reader in understanding the reporting objectives by providing another perspective on the issues.

250. The financial information needs of the four user groups can be classified into six categories:

1. Information on the sources and uses of budgetary resources
2. Information about operations and the related resources
3. Information about the government's assets
4. Information about the government's liabilities and financial responsibilities
5. Information that addresses concerns with the future
6. Information that discloses the levels of financial controls

251. In some cases, the specific nature of the information would be basically the same for all four groups of users; only the level of detail would vary. For example, the amount of unobligated budgetary authority available to be obligated would be of interest to program managers wanting to avoid violations of the Anti-Deficiency Act and to executives wanting to know the availability of budgetary resources that can be reprogrammed for other purposes.[19]

252. In other cases, the specific nature of the information would vary, depending on the reporting entity, the report user and the use to which the information was put. For example, "error rates" could refer to errors in determining the monthly payment an individual was entitled to receive from the government or errors in calculating fees that a company was required to pay the government.

[19]"Obligations" has a meaning in federal accounting similar to that of "encumbrances" in state and local governmental accounting; that is, it reflects a reservation of appropriated spending authority that will be used to pay for a specific contract, a purchase order, or another item.

Information On The Sources And Uses Of Budgetary Resources

253. The budget is the starting point for the government's finances. All users want to know the makeup of the budget, i.e., the budget authority, the obligations, the outlays, the receipts and offsetting collections, etc. They want to know how the budget was executed and particularly whether it was executed in accordance with the appropriation statutes and other laws affecting the entity's finances. They want to know the status of the budgetary resources, including the extent of obligated and unobligated budget authority. Finally, they want to know the sufficiency of the budget authority for covering future commitments.

Information About Operations And The Related Resources

254. Accompanying the need for information about budgetary resources is a need for information about the operations of the government's programs. This includes information about the costs of the programs, classified in ways that provide further understanding, such as by program or activity, direct or indirect, fixed and variable, in comparison to estimates, or by object (e.g., personnel). Information that discloses unit, total, and marginal costs and changes in costs is also useful.

255. Cost information reflects the inputs for government services. Equally useful is information about the outputs, outcomes, efficiency, and effectiveness of government services, by themselves or in relation to a budget or goals, and any changes. This would include an identification of the periods in which the accomplishments would be realized. Such information helps form a basis for voting, funding, and management decisions.

Information About The Government's Assets

256. Financial statement users want considerable information about the government's assets. They want to know whether the balances in the trust and revolving funds will be sufficient for fulfilling the fund's purposes. They want to know the nature and amounts of receivables owed the government and whether the receivables will be paid. They are interested in the size and condition of the inventories and whether they can be used as intended or, if not, how much would be received for their disposition. There is much the users want to know about the government's physical assets: their value, their expected service life, the replacement costs, and the impact of the maintenance that has been deferred.

257. The government also holds assets as a custodian or only until the assets can be sold. Examples are seized or forfeited assets. Information about these assets helps to establish

accountability for them and to make decisions about the best time and method for their disposal.

Information About The Government's Liabilities And Financial Responsibilities

258. Users want to know what the government owes and whether the amounts are short term and precisely definable, long term and only an estimate, or just a contingency related to an enterprise or activity that is not a direct and current government responsibility, e.g., government-sponsored enterprises. This information helps the reader assess the government's ability to continue to operate at its current levels over a period of time and/or whether a tax increase is likely.

259. The changes in the amounts owed from year to year are also important. The user often is willing to settle for (or may actually prefer) ranges rather than point estimates and/or net present values rather than nominal (undiscounted) amounts.

Information That Addresses Concerns With The Future

260. The federal government is responsible for the country's well-being. Its financial actions affect that well-being, both currently and in the future. Thus, users look not just for information to evaluate the condition of the trust funds upon which they rely for future security. They also want information to assess the likelihood of tax increases, service reductions, and changes in the inflation rate.

261. They therefore want information about possible sources of additional financial resources. They want to see the amounts of resources expended on consumption activities in comparison to investment activities, such as research and development. They want information on other growth-stimulating activities. On the other hand, they still want to be able to assess where spending can be reduced significantly.

262. Finally, they want to know the magnitude of the probable future deficits, the cost burden this will place on taxpayers, and the potential effect that this burden might have on the quality of life.

Information That Discloses The Levels Of Financial Controls

263. Because the government spends such large amounts of monies, taxpayers and other citizens are naturally concerned that the resources they supply are being protected from fraud, waste, and abuse and that the errors are minimal. They want to know that controls are in place and operating effectively and that problems are being quickly identified and corrected. They are particularly concerned that identified high risks are addressed and that adequate funds are devoted to eliminating the risk.

264. This concern is not just with the monies expended directly by the government. It also extends to the monies expended by the individuals and organizations that receive government contracts or grants.

Appendix C: Selected Federal Reports Prepared On A Recurring Basis

265. This appendix classifies some well-known reports according to the categories set forth in figure 1 in Chapter 8. Reports are classified according to whether they are primarily financial or nonfinancial and whether they have primarily a special or a general purpose. The classification is somewhat subjective. It is based on the general nature or emphasis of the reports. Many reports combine information and functions from different categories.

266. All these reports contribute to meeting the Board's reporting objectives for some users. However, many of the specific reports listed—economic reports dealing with the nation as a whole, for example—will be influenced only indirectly, if at all, by the Board's standards. Indeed, because they deal with transactors other than the government (such as private citizens and corporations, states and local governments, and not-for-profit entities), economic reports fit within the context of figure 1 only to the extent that they may provide information to assess the government's operating performance and stewardship.

Financial Information—Special Purpose

- Budget of the U.S. Government
- Analysis of the President's Budget Proposals (CBO)
- Economic and Budget Outlook Report (CBO)
- Economic and Budget Outlook Report Update (CBO)
- Midsession Review of the Budget
- Budget Enforcement Act Reports: Preview, Update, and Final Sequestration
- Request for Apportionment (SF 132)
- Report on Budget Execution (SF 133)
- Economic Report of the President
- Federal Reserve Bulletin
- OPM Forms 1351 A-D: Work years and personnel costs reports
- Prompt Payment Report

Financial Information—General Purpose

- Annual financial statement (principal financial statements, including footnotes and combining financial statements if applicable) required by the CFO Act on revolving funds, trust funds, substantial commercial functions, and pilot federal agencies
- Annual financial reporting by agencies required by Treasury (SF 220 series)

- Prototype Consolidated Financial Statements of the U.S.
- The U.S. Government Annual Report and Appendix (Treasury)
- Monthly Treasury Statement of Receipts and Outlays of the U.S.
- Monthly Statement of Public Debt
- Daily Treasury Statement (on cash and debt)

Nonfinancial Information—General Purpose

- Annual departmental reports to the President and Congress
- Nonfinancial information required by the CFO Act in the overview, supplemental information, and other portions of the reports

Nonfinancial Information—Special Purpose

- Reports required by the Federal Managers' Financial Integrity Act of 1982

Statement of Federal Financial Accounting Concepts 2: Entity and Display

Status

Issued	June 6, 1995
Affects	No other statement.
Affected by	• SFFAS 7, paragraphs 90-102, which affect paragraphs 64, 74, 105 of this statement, and add Appendix I-G. • SFFAS 27, paragraph 38, amends footnote 3. • SFFAS 31, paragraph 35, amends paragraphs 84 and 102. • SFFAC 6, paragraphs 6 through 22, amend par. 2, 3, 55, 69, 72-74, 76-79, 81, and 108 as well as footnotes 11, 12, 12a, 14, and 17. • SFFAS 43, paragraph 6 amends footnote 3. • SFFAS 47, paragraphs 90 through 105 amend par 2-7, 10, 18, 29, 38-53, and 78. • SFFAS 53 amends paragraph 105.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

This concepts statement describes the basis for defining a reporting entity for the general purpose financial reporting performed by the Federal government and/or entities thereof. For any entity to be a reporting entity it should meet all of the following criteria:

- There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.
- The entity's scope is such that its financial statements would provide a meaningful representation of operations and financial condition.
- There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

This concepts statement also describes the items that should be included in Federal financial reports and presents illustrative statements depicting desirable displays of financial information. The items include:

- management discussion and analysis;
- balance sheet;
- statement of net costs;
- statement of changes in net position;

- statement of custodial activities, when appropriate;
- statement of budgetary resources;
- statement of program performance measures;
- accompanying footnotes;
- required supplemental information pertaining to physical, human, and research and development capital and selected claims on future resources, when appropriate; and
- other supplemental financial and management information, when appropriate.

SFFAS 7, *Accounting for Revenue and Other Financing Sources*, amends the above list to include “statement of financing.” SFFAS 7 also presents an illustrative statement of financing to amend the displays shown in Appendix A of SFFAC 2.

Table of Contents

Introduction

1. A basic postulate of accounting is that accounting information pertains to entities, i.e., circumscribed legal, administrative, fiduciary, or other organizational structures. Another basic postulate is that entities use financial reports to communicate financial and related information about the entity to persons concerned with the entity.

2. The purpose of this statement is to establish concepts regarding what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there should be financial reports (hereinafter called "reporting entities"), establishes an organizational perspective for considering the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, suggests the types of information each type of report would convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

3. [Paragraph 3 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 92.][1]

4. [Paragraph 4 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 92.]

5. [Paragraph 5 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 92.][2]

6. The concepts, as defined in this statement, are intended primarily for the general purpose financial reporting performed by Federal entities. This is the financial reporting that these entities would undertake to help meet the objectives defined in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, "Objectives of Federal Financial Reporting." These objectives are as follows:

    - **Budgetary integrity.** 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.
    - **Operating performance.** Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the

[1][Footnote 1 was rescinded by SFFAS 47, paragraph 92.]

[2][Footnote 2 was rescinded by SFFAS 47, paragraph 92.]

manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

- **Stewardship.** 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 conditions have changed and may change in the future.
- **Systems and control.** Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure proper execution of transactions, safeguard assets, and support performance measurement.

6a. SFFAC 1 also discusses accountability and users' information needs as the foundation for the objectives of federal financial reporting. Specifically, paragraphs 71-72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. …The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability." Based on the concepts established in SFFAC 1, it is clear that accountability is a fundamental goal of financial reporting to be considered in establishing the boundaries of general purpose federal financial reports.

7. [Paragraph 7 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 94.]

8. The entity and display concepts presented in this statement do not preclude the specification of ad hoc or temporary reporting entities to meet special reporting needs of users of Federal agencies' financial information. Nor do they preclude a reporting entity from preparing special purpose financial reports to meet the specific needs of persons in the reporting entity or in response to requests from persons outside the entity for certain financial information; or from preparing a so-called "popular report," which provides a simplified, highly readable, easily understandable description of a reporting entity's finances. These statements would not necessarily purport to be presented in accordance with generally accepted accounting principles.

Reasons For Defining Reporting Entities

9. The most basic reason for having an explicit understanding of what the reporting entity entails is to ensure that the users of the entity's financial reports are provided with all the information that is relevant to the reporting entity, subject to cost and time constraints. Clearly defining the boundaries of the reporting entity provides the users with a clear

understanding of what the reporting entity encompasses. It helps to establish what information is relevant to the financial statements and what information is not.

10. Other reasons for having an explicit understanding of what the reporting entity entails are to:

- ensure each reporting entity includes information to support accountability by including all relevant organizations—those that are in the budget, owned by the Federal Government, or controlled by the Federal Government with risk of loss or expectation of benefit;
- assist in making comparisons among comparable reporting entities by reducing the possibility of unintended or arbitrary exclusions or inclusions of entities;
- assist in making comparisons among alternative ways to provide similar services or products;
- be able to distribute costs properly and fully and to properly attribute the responsibility for assets and liabilities; and
- facilitate evaluating performance, responsibility, and control, especially where one agency is the provider or recipient of services attributable to or financed by another agency.

Structure Of The Federal Government

11. The Federal Government is an extremely complex organization composed of many different components. For accounting and reporting purposes, it may be viewed from at least three perspectives. However, the nature of each type of component and the relationships among the components and perspectives are not always consistent.

Organization Perspective

12. The first type of perspective is the **organization** perspective. The Federal Government is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include the 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, services, and corporations. Many of these are further divided into even smaller suborganizations. On the other hand, there are small agencies for which division into smaller units is generally not considered appropriate.

Budget Perspective

13. From another perspective, the government is composed of accounts presented in the budget, hereinafter referred to as **budget accounts**. Budget accounts are composed of expenditure (appropriations or fund) accounts and receipt (including offsetting receipt) accounts. The size and scope of these accounts varies according to Congressional preference. They can vary from very small accounts, which are useful for constraining management, to very large accounts, which can be used to finance many activities.

14. Budget accounts are not the same as Treasury accounts. The latter are accounts established in the Treasury to, among other purposes, record the appropriations and other budgetary resources provided by statutes and the transactions affecting those accounts. For the most part, budget accounts are aggregations of Treasury accounts. Also, Treasury accounts include deposit accounts as well as budget accounts.

15. Nor are budget accounts the same as the uniform ledger accounts established by the U.S. Government Standard General Ledger (SGL). SGL accounts record specific homogeneous types of transactions and balances that aggregate to specific classifications on the financial statements. They have been established so that agencies can establish control over their financial transactions and balances, meet the basic financial reporting requirements, and integrate budgetary and financial accounting in the same general ledger.

16. A budget account may coincide with an organization or one or more of its suborganizations. Other times, several budget accounts need to be aggregated to constitute an organization or sub-organization.

17. Budget accounts are classified as federal funds or trust funds. Any account that is designated by the laws governing the federal budget as being a trust fund is so classified. Federal funds comprise the larger group and include all transactions not classified by law as trust funds. Three components make up federal funds: the general fund, special funds, and revolving funds. The definition of each of these categories can be found in the OMB circular A-11 and the GAO Glossary of Terms Used in the Federal Budget Process.

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 dedicated collections.

19. In customary usage, the term “trust fund” refers to money belonging to one party held “in trust” by another party operating as a fiduciary. The money in a trust fund 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 trust 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.

20. Special funds and trust funds, except trust revolving funds, are aggregates of budget accounts. They normally consist of one or more receipt accounts and one or more expenditure accounts. Among the trust funds, social insurance programs (such as social security and unemployment compensation) have the largest amount of funds and federal employee programs (such as retirement and health benefits) the second largest. Together they make up about 90 percent of all trust fund receipts. Other trust funds include excise tax financed programs for highway construction, airports and airway operations, and other public works. Like other budget accounts, trust funds are usually the responsibility of a single organization, although sometimes they are the responsibility of more than one organization.

21. Budget accounts are also categorized, as mandated by law and defined by OMB, into functions and subfunctions that represent national needs of continuing national importance and substantial expenditures of resources. Examples of functions are national defense and health.

Program Perspective

22. From a third perspective, the government is composed of **programs and activities**, i.e., the services the organizations provide and the specific lines of work they perform. Each program and activity is responsible for producing certain outputs in order to achieve desired outcomes.

23. There is no firm definition for the term “program;” it varies in the eye of the beholder. For example, the Highway program could relate to the entire Federal highway program, the program to build interstate highways (in contrast to city streets, secondary roads, etc.), or a program to build a highway between two specific points. Moreover, in accordance with the sequester provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, the House and Senate Appropriations Subcommittees annually define, in the Committee Reports, the meaning of “Programs, Projects, and Activities” as they relate to each of the Appropriations Acts.

24. The term “program” is also often used interchangeably with the terms “function” and “sub-function” (see paragraph 21). Generally, however, the term “function” would be used only for the functions defined in the budget. Otherwise, the term “program” would be used.

Intertwining Of The Perspectives

25. The programs are administered by the organizations and financed by the budget accounts. In a few instances, there is a one-to-one relationship among the three perspectives. A single budget account finances a single program and organization. Thus, the program is carried out only by the single organization and the organization performs only one program.

26. However, most programs are financed by more than one budget account, some of which might not be under the control of the organizational unit administering the program. Some programs are even administered by more than one organization. Likewise, a single organization or budget account could be responsible for several programs. In some instances, a program could also be considered an organizational unit, e.g., the Center for Disease Control and Prevention.

27. Furthermore, some of the support necessary to perform a program is frequently provided by other organizations and/or financed by other budget accounts. Examples are the computer support for a program that is obtained from a central unit within the department, or retirement health costs for a program's current and former employees.

28. This complex situation is the result of the evolution of Federal organizations, programs, and budgetary structures over many years. As Federal missions and programs have expanded and changed, new departments have been created, new organizations have been added to existing departments, and new duties have been assigned to existing organizations on the basis of various considerations. Similarly, the budget structure has evolved in response to the needs of the Congress; its committees and subcommittees; and various initiatives by the President, program managers, and interest groups.

Identifying The Reporting Entities For General Purpose Financial Reporting

29. As stated, reporting entities are entities that issue general purpose financial statements to communicate financial and related information about the entity.[2.1] For any entity to be a reporting entity, as defined by this Statement of Federal Financial Accounting Concepts, it would need to meet all of the following criteria.

[2.1]The Office of Management and Budget specifies the form and content of agency financial statements, pursuant to its authority under the Chief Financial Officers Act of 1990, as amended (title 31, U.S. Code, section 3515(d)) through issuance of Bulletins and Circulars. OMB intends to base form and content on the concepts contained in this Statement. Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees.

- There is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof (assuming that the entity is included in the budget), and held accountable for the entity's performance.
- The entity's scope is such that its financial statements would provide a meaningful representation of operations and financial condition.
- There are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

30. Budget accounts, in and of themselves, do not meet the criteria in the preceding paragraph and, therefore, would not be considered a reporting entity for the purposes of issuing general purpose financial statements. Also, the size and scope of the budget accounts across all government agencies lack sufficient consistency for them to be universally considered as the reporting entity. Similarly, programs generally do not meet the criteria in paragraph 29 and, therefore, would not be a considered a reporting entity that prepares general purpose financial statements.

31. On the other hand, organizations, and particularly larger organizations, meet the criteria in paragraph 29. While the occasional overlap of programs and budget accounts among more than one organizational unit could complicate financial reporting, the association of data with the responsibility centers, revenue centers, profit centers, cost centers, etc. which managers typically use for organizing and operating permit the following:

    - aggregating information for not only the organization (and suborganizations), but also for one or more of the programs performed by the organization, and one or more of the budget accounts for which the organization is responsible, and
    - the subsequent arraying of the information not only by organization, but also by sub-organization, program, and/or budget accounts.

32. This approach to defining the appropriate reporting entities in the Federal Government supports establishment of accountability in the organizations (and suborganizations) while still enabling them to provide information pertaining to their programs.

33. Although a reporting entity might not control all the budget accounts used to finance one or more of the programs it administers, any revenues attributable to or costs incurred on behalf of the programs it administers should be associated with that reporting entity. This notion holds true regardless of whether the reporting entity maintains personnel on a payroll.

34. The departments and major independent agencies are organizational units and therefore would be the primary reporting entities. However, in many instances, financial statements that present aggregations of information into suborganization entities, i.e., bureaus, administrations, or agencies, may be more useful than statements that present only

aggregations into organizational entities. The former can provide a better understanding of the financial results and status of the many individual suborganizations and programs constituting a department or major independent agency. They can reveal instances where programs are carried out by several suborganizations within the department or major independent agency.

35. Similar to other budget accounts, trust funds, special funds, and revolving funds are usually administered by a single organization. For financial reporting purposes, the organization would be the reporting entity; the trust fund or revolving fund would be a component of the organization that administers the fund in the same manner that a suborganization or other type of budget account is a component of the organization. This would not preclude separate reporting for the trust fund, special fund, or revolving fund by the managing organization, nor would it preclude disclosure of trust fund, special fund, or revolving fund information within the organization's report when there is sufficient interest.[3]

36. Likewise, some programs are coterminous, i.e., share the same boundaries, with an organization or sub-organization, while other programs—such as student loan programs—are the component for which resources are deployed, are responsible for achieving objectives, and/or are of great interest to outsiders. In both instances, the financial operations and results of the program might warrant highlighting or even separate reporting by the organization or suborganization which manages the program.

37. Financial statements for organizationally-based reporting entities may be audited and issued to external parties, unaudited and used for internal management purposes, or, perhaps to be more relevant and meaningful, combined with financial statements from other organizationally-based reporting entities.

38. The ultimate aggregation of organizations is into the Federal Government which, in reality, is the only independent economic entity. The Federal Government encompasses all of the resources and responsibilities existing within the component reporting entities. The aggregation includes organizations for which the Federal Government is accountable as well as other organizations for which the nature and significance of their relationship with the

[3]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 revenues 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 will report all assets, liabilities, revenues, and expense 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 Funds from Dedicated Collections*. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.

Federal Government are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

Criteria For Including Components In A Reporting Entity

39. [Paragraph 39 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 99.]

40. [Paragraph 40 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

41. [Paragraph 41 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

42. [Paragraph 42 was rescinded by SFFAS 47, Reporting *Entity,* paragraph 99.]

43. [Paragraph 43 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

44. [Paragraph 44 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

45. [Paragraph 45 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

46. [Paragraph 46 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.][4]

47. [Paragraph 47 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 99.]

48. [Paragraph 48 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

49. [Paragraph 49 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.][5]

50. [Paragraph 50 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 99.]

Other Aspects Concerning Completeness of the Component Reporting Entity

51. Identifying the organizations to include in the reporting entity is one aspect of ensuring that the users of a reporting entity's financial reports are provided with all the information

[4][Footnote 4 was rescinded by SFFAS 47, paragraph 99.]

[5][Footnote 5 was rescinded by SFFAS 47, paragraph 99.]

relevant to the reporting entity. However, because the only independent economic entity is the entire Federal Government, financial resources or free services are often provided from one component in the government to another component without a quid pro quo. For example, a portion of the retirement costs of Federal employees is reported by the Office of Personnel Management rather than the organizational entities employing the persons. Thus, within parameters more appropriately established in accounting standards, it is important to ensure that the reporting entity's financial reports include amounts that are attributable to the reporting entity's activities, even though they are recorded elsewhere. This is particularly important for costs associated with the use of human resources; personnel services are such a major part of most government activities. It is also important for the costs of services provided by other reporting entities, such as computer services provided by another unit.

52. [Paragraph 52 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 102.][6]

53. [Paragraph 53 was rescinded by SFFAS 47, *Reporting Entity,* paragraph 102.][7]

Need to Distinguish between Consolidation Entities and Disclosure Entities

53A. The Federal Government is a large and complex organization. In order to fulfill public policy objectives, the Federal Government may use both consolidation entities (such as departments and agencies) and organizations that are distinct from consolidation entities to fulfill public policy objectives (such as financially independent organizations). These distinct organizations are referred to collectively as "disclosure entities."

53B. Disclosure entities may maintain a separate legal identity, have a governance structure designed to insulate the organization from political influence, and/or be granted relative financial independence. Despite disclosure entities' relative operational and financial independence, accountability for all organizations owned or controlled by the Federal Government rests with the Congress and/or the President. So, both consolidation entities and disclosure entities should be included in financial reports to provide accountability.

53C. It may be difficult to provide accountability, by meeting financial reporting objectives, through consolidated financial statements because they blur the distinction between

[6][Footnote 6 was rescinded by SFFAS 47, paragraph 102.]

[7][Footnote 7 was rescinded by SFFAS 47, paragraph 102.]

consolidation entities and disclosure entities. Consolidated financial statements may obscure the fact that resources and resource allocation decisions for disclosure entities are more independent than similar decisions for consolidation entities. While consolidation entities are financed by taxes and other non-exchange revenue and governed by elected officials, disclosure entities often do not rely on taxes and other non-exchange revenue for financing or elected officials for spending authority. For example, a single-column presentation of information for all organizations likely would create a risk of incorrect inferences. Such inferences may include the amount of assets and revenues available for consolidation entities to use in general government activities, and the extent to which taxpayers stand ready to liquidate liabilities and meet expenses of disclosure entities.

53D. Maintaining a distinction between consolidation entities and disclosure entities may more effectively meet federal financial reporting objectives. Such a distinction may be maintained through discrete presentation of information regarding disclosure entities. Nonetheless, disclosures are not a substitute for consolidation entities recognizing the financial effects of transactions with disclosure entities.

53E. Consolidated financial statements for only consolidation entities will facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Consolidation aggregates the individual financial statements of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing consolidated activities supported by taxes and other non-exchange revenue, resources, and obligations. Consolidation entities are considered federal entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. The following sections discuss display of information in consolidation entity financial reports.

Displaying Financial Information

54. Financial information is typically provided by or for a reporting entity through financial statements. Financial statements represent the principal means of communicating accounting information about an entity's resources, obligations, revenues, costs, etc. to those outside the entity. However, financial statements, and particularly those prepared for governmental and other not-for-profit organizations, may also contain information from sources other than accounting records. Also, management may communicate information to those outside the entity by means of financial reporting other than financial statements, either because the information is required to be disclosed by statute, regulation, or custom; or because management believes the information would be useful to those outside the entity and discloses it voluntarily.

55A. To enhance confidence in the reliability of information presented in financial statements, the statements are often, but not always audited by Inspectors General, independent accounting firms, or the Government Accountability Office. In developing accounting standards, the Board considers whether information should be categorized as basic information, required supplementary information (RSI), or other accompanying information (OAI). Distinguishing these categories is important because each category is subject to different procedures and reporting requirements under generally accepted government auditing standards (GAGAS). When an auditor is engaged to audit an entity's financial statements, basic information as a whole is subject to testing for fair presentation in conformity with GAAP. However, RSI and OAI are unaudited, but subject to certain procedures specified by GAGAS for RSI and OAI, respectively. To assist users in analyzing the different types of information within financial reports, these differences must be conveyed and can be accomplished in a variety of ways. The traditional approach is to separate the categories of information. However, the categories may be commingled if the RSI and OAI are clearly labeled as "unaudited" or distinguished in a manner that informs the reader of the level of assurance provided.

55B. Classification of the information as basic information, RSI, or OAI does not constrain the form of presentation. For example, financial statements may be presented as basic financial statements, RSI, or OAI. Information can be required or encouraged to be in the form of financial statements, narrative, graphs, or tables. To clearly communicate the intended status, the Board must specify whether the information is to be considered basic information, RSI, or OAI. Selecting a category may involve a process which is described in paragraphs 73A to 73G.

56. In the Federal Government, there are several types of reporting entities (organizations, suborganizations, programs, and the government as a whole) and several financial reporting objectives (budgetary integrity, operating performance, stewardship, and systems and control). Each of the reporting objectives can be met to a certain degree by the statements prepared by or for one type of reporting entity and to a greater or lesser degree by the statements prepared by or for the other types of reporting entities. For example, the objective of budgetary integrity can be best met with the program and financing schedules prepared for individual budget accounts. The objective of operating performance can be best met with financial statements from organizations/suborganizations and programs (although financial statements at this level can also help readers evaluate the reporting entity’s budgetary integrity). The objective of stewardship can be best met with a financial statement for the entire government. Meeting the financial reporting objectives in their totality requires financial statements from all of the types of reporting entities.

Stock Statements

57. The financial reporting objectives are also met with different types of financial statements. A financial statement that presents financial information for an entity as of a particular point in time, however the information is measured, i.e., budgetary, cash, or accrual, is often characterized as a stock statement. An example of a stock statement is a **balance sheet**. It presents the total balances of assets, liabilities, and net position of an organization as of a specific time.

Flow Statements

58. Another type of financial statement provides information on an entity's flows of revenues, receipts, expenditures, expenses, gains, losses, and/or other changes of the entity's net resources during a period, however they are measured, i.e., budgetary, cash, or accrual. This type of financial statement is frequently characterized as a flow statement. The traditional flow statement is a statement of operations and changes in net position issued by private sector, profit seeking organizations. It presents the results of an entity's operations for a reporting period, including the changes in the entity's net position from the end of the prior reporting period. This type of statement is particularly useful for private sector, profit seeking organizations since their objective is to generate earnings and returns on investment. The statement of operations and changes in net position presents the revenues the entity receives, the expenses incurred to generate the revenues, the amount left for the entity's owners, and the resulting effect on the owners' equity.

59. The Federal Government and most of the other reporting entities in the Federal Government are spending entities whose objective is to provide services, some of which are financed by revenues received from the recipients of the service, and some of which, if not all or most of which, are financed by taxes and other unearned revenues.[8] Thus, the most useful information a flow statement could present is the total and net costs of the services, i.e., how much of the services provided by the entity was financed by the taxpayers. This type of statement, which would be a **statement of net costs**, would support the achievement of Federal financial reporting objective 2A. Objective 2A states that "Federal financial reporting should provide information that helps the reader to determine the costs of providing specific programs and activities and the composition of, and changes, in these costs."

[8]The Board is currently developing an Exposure Draft entitled *"Revenue and Other Financing Sources"* which addresses more fully the types of revenues (i.e., exchange versus non-exchange and earned versus unearned revenues) discussed here.

60. As indicated, revenues provided in exchange for the services, i.e., earned revenues, are not the only manner in which a Federal Government entity finances the services it provides. Other sources of financing are the appropriations received from the Congress, and such various non-exchange revenues as fines, donations, and transfers from other agencies. Therefore, another useful flow statement would be a **statement of changes in net position** that presents the manner in which the entity's net costs were financed and the resulting effect on the entity's net position. This also would be consistent with Federal financial reporting objective 2: "Federal financial reporting should assist report users in evaluating. . .the manner in which these efforts and accomplishments have been financed...."

61. The collection of the major sources of funds for the appropriations, e.g., taxes, royalty payments, and fines, is the responsibility of just a few reporting entities, especially the Internal Revenue Service, the Customs Service, and the Minerals Management Service. These entities are functioning in a custodial capacity and are required to turn the taxes or other monies they collect over to the Treasury or other organizations. The results of these entities' custodial activities could be reported in a flow statement that provides an understanding of from whom the taxes or other monies were collected and to whom they were distributed. This would be called a **statement of custodial activities**.

62. For many reporting entities, and particularly those engaged in reimbursable activities, it is useful to have an understanding of the sources and amounts of cash provided to the entity for operating, investing, and financing purposes and the major purposes for which the cash was used. This type of information can be displayed with a statement of cash flows, in accompanying footnotes, or as supplemental financial and management information.

Budget Statement

63. Meeting the first objective of SFFAC No. 1, "Objectives of Federal Financial Reporting," namely the budgetary integrity objective, necessitates that the reader receive assurance that

- the amounts obligated or spent did not exceed the available budget authority,
- obligations and outlays were for the purposes intended in the appropriations and authorizing legislation,
- other legal requirements pertaining to the account have been met, and
- the amounts are properly classified and accurately reported.

64. This information is provided in other reports, but there needs to be auditor involvement to provide assurance as to the reliability of the information. The assurance as to reliability of the information could be accomplished by including a **statement of budgetary resources** in the reporting entity's financial statements, recognizing that the statement will likely be

subject to audit. The presentation of data could be for the reporting entity as a whole, for the major suborganization units (assuming there is congruity among the major suborganization units and the budget accounts), or for the aggregations of the major budget accounts, rather than for the individual budget accounts of the entity or other types of entities. Violations of budgetary integrity at the account level occurring during the current year could be disclosed on an exception basis. (Many violations of budgetary integrity would also be violations of the Anti-Deficiency Act. Disclosure in the financial statements notwithstanding, these violations would also have to be reported as required by the Act.)

Reconciliation Statement--Budgetary And Financial Accounting

64A. 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 and outlay-based measures used in budgetary reporting.

64B. 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 **Budget and Accrual Reconciliation** (BAR) that reconciles the net budgetary outlays 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.

Performance Measures Statement

65. The second objective of Federal financial reporting states, in part, that Federal financial reporting should provide information that helps readers of the financial reports determine the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs. This suggests that a **statement of program performance measures**,[9] i.e., one or more statements presenting service efforts and accomplishments measures for each of a reporting entity's significant programs, is necessary.

[9]The Board does not consider the Statement of Program Performance Measures to be a basic financial statement.

66. The Federal Government is increasing its interest in measuring and reporting program performance, as evidenced by the enactment of the Government Performance and Results Act and increasing emphasis during budget reviews on program performance. Moreover, the ability to seek and obtain maximum return from increasingly limited resources can be enhanced by an understanding of the results of the programs for which budget resources have been expended. In the final analysis, the objective of the Federal Government is to provide services, in contrast to the objective of private sector organizations, which is to earn profits and enhance the return on investment, both of which are monetary objectives. All of these factors suggest that the statement of program performance measures is not only an appropriate statement, but likely to be the most important statement for those persons interested in how a Federal entity is using its resources.

67. For a statement of program performance measures prepared by an organization-level reporting entity, the outputs and outcomes would be related to the performance of the entity itself and its own programs, e.g., clients vaccinated, illnesses prevented. For the government-wide report, broader measures of outcomes and impacts that depended on the joint efforts of several reporting entities would be appropriate, e.g., state of the economy, national security, environment, personal health, social welfare, although some narrower outcome measures might also be included.

Other Information

68. 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.

69. It is also necessary to convey more general information about the reporting entity. This could entail such matters as a brief description of the reporting entity; its missions, goals, and objectives; the programs it provides and the major recipients for the program; its major sources of funding; the manner in which the reporting entity is organized; its personnel resources; highlights of the entity’s accomplishments during the reporting period; selected measures of program performance abstracted from the statement of program performance; problems encountered or targets missed and the reasons why; financial highlights and trends; expected problems and challenges; future targets the entity is setting for itself; and any other information the agency head or CFO considers necessary to fully and fairly provide an understanding of the entity’s financial affairs. This type of information is typically presented in what has come to be known as a **management’s discussion and analysis** or **overview** of the reporting entity.

70. The third objective of Federal financial reporting is that it “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 conditions have

changed and may change in the future.[10] This objective requires a reporting of information concerning investments in education, training, research, and development and certain types of property, plant, and equipment that can affect the nation's future wealth, and to the claims on future budgetary resources resulting from prior decisions and actions.

71. The information pertaining to the aforementioned investments, certain types of property, plant, and equipment,[11] and claims on future budgetary resources is maintained in part in the entities' general ledgers and, in part, external to the general ledgers. Some of the information is recorded in units other than dollars, e.g., acres, millions of square feet. Finally, some of the information is not subject to the types of controls present in a system of double entry recordkeeping. Accordingly, a more suitable way to fulfill the third reporting objective would be to display the appropriate information as **required supplemental information** rather than attempting to include it in financial statements.[12]

72. [Rescinded per SFFAC 6.]

73. The fourth objective, systems and controls, is fulfilled, in part, by the act of preparing the financial statements. Other ways the fourth objective could be fulfilled through the audited financial reporting process is by a management assertion that would accompany the financial statements and/or an auditor's attestation on the financial statements. The management assertion would be an acknowledgment of its responsibility for the accuracy of the information in the financial statements, the completeness and fairness of the presentation of the information, the accuracy of the information in all material respects, and the reporting of the information in a manner designed to fairly present financial position and results of operations. The assertion could also include a statement regarding the adequacy of the entity's systems and controls, accompanied by the auditor's concurrence with the assertion.

[10] A complete discussion of the third objective for Federal financial reporting, which is called the "stewardship objective," is contained in paragraphs 134 to 145 of Statement of Federal Financial Accounting Concepts No. 1, *"Objectives of Federal Financial Reporting."*

[11] [Text rescinded per SFFAC 6.]

[12] [Text rescinded per SFFAC 6.]

Distinguishing Basic Information, RSI, and OAI

Determining Required Information

73A. Selecting a category for communicating information may involve a process that begins with determining what information should be required. Required information is information that consists of basic information and RSI. An item of information is a candidate for required information if it is consistent with the objectives of federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations. The Board developed these factors earlier in the conceptual framework. SFFAC 1 identifies the reporting objectives (paragraphs 112 to 150) and the qualitative characteristics (paragraphs 157 to 164). It also discusses cost versus benefit considerations (paragraphs 151 to 155).

Determining Basic Information versus RSI

73B. Information that meets the criteria for required information is a candidate for basic information or RSI. Basic information is information which is essential for the financial statements and notes to be presented in conformity with GAAP. The FASAB standards are the core[12.1] of GAAP and auditors may be engaged to express an opinion as to whether basic financial statements and notes are presented in conformity with those criteria.

73C. RSI is information that a body that establishes GAAP requires to accompany basic information. It may be experimental in nature to permit the communication of information that is relevant and important to the reporting objectives while more experience is gained through resolution of accounting issues. Also, the information may be expressed in other than financial measures or may not be subject to reliable estimation. As issues are resolved, the information may be considered basic at some point in the future.

73D. The Board specifies what information should be presented as basic information and what information should be presented as RSI. Assessing whether required information is a candidate for basic information or RSI may involve the Board's consideration of a range of factors which are listed in Table 1: Factors to Consider in Distinguishing Basic Information from RSI on page 107. The factors are not listed in a particular order and some may convey similar ideas. In addition, different Board members may assign different weight to each factor. Thus, the factors provide a general framework for each Board member's judgment and are not considered to present a decision tree, hierarchy, or precise algorithm for classifying items.

[12.1]The first and highest level of the GAAP hierarchy comprises standards and interpretations. Lower level GAAP may not conflict with standards or interpretations.

73E. For example, members may consider the relevance of the information to fair presentation. If the information has a high relevance to fair presentation, it may be a candidate for basic information communicated by financial statements and notes to the financial statements. The financial statements and notes could not be considered fairly presented if the information is missing or materially misstated. The rationales for some of the other factors that members may consider are:

a. Use of various types of financial data or financial transaction data. Members may deliberate the nature of the data used or the type of system used to process the information. Financial data used or data derived from a system for processing financial transactions, may be more likely to be considered basic information.

b. Level of importance the Board wishes to be communicated in the financial report or the auditor's report. In addition to the nature of the information, the Board may take into account the effect of categorizing an item as basic information or RSI in the financial report and what the auditor's report would communicate if the item is missing or materially misstated. By designating an item as basic information rather than RSI, the Board can have some bearing on the level of importance conveyed in the financial report and auditor's report. In other words, users may pay less attention to items categorized as "supplementary" in the financial report. Conversely, they may be more concerned with the auditor's conclusions regarding the fair presentation of the financial statements. Hence, the more important the item, the more likely it would be a part of the financial statements and notes prepared in conformity with GAAP, such that if the item is missing or materially misstated, the matter would be conveyed in the auditor's report on the fair presentation of the financial statements.

c. The extent to which the information interests a wide audience (rather than specialists). If an item of information is of great interest to users, the information may be a candidate for basic information. Conversely, if the item is primarily of interest to subject matter specialists, the information may accompany the basic information as RSI.

d. Extent to which there are not alternative sources of reliable information. If organizations routinely publish an item of information that is scrutinized by independent advisors, it may be more likely to be considered RSI than basic information.

e. Agreement on criteria that permit comparable and consistent reporting. If there is a lack of specific criteria for measuring an item, preparers may have great discretion in developing their calculations and auditors may lack criteria necessary for the expression of an opinion. The item of information may be a candidate for RSI.

f. Experience among users, preparers, and auditors with the information. The Board may consider the views of expert users, preparers, and auditors in developing measurement criteria for basic information. If the level of experience regarding an item is low, input on specific criteria may not be available. Also, when there is not sufficient experience to develop measurement criteria, auditors may have concerns about expressing an opinion on the information. They may express qualifications or include explanations in their report. Categorizing the information as RSI may encourage reporting while more experience is gained and criteria developed.

g. Benefit/cost ratio of using resources to compile the information as well as ensure accuracy. The Board may consider the benefit and cost associated with producing and auditing the item of information.

OAI

73F. If an item of information does not meet the criteria for basic information or RSI, it becomes a candidate for OAI. OAI is information that accompanies basic information and RSI, but is not required by a body that establishes GAAP. Some entities may desire to report information to supplement required information and enhance a user's understanding of the entity's operations or financial condition. This may include, but is not limited to, information on delivery times, turnover, and wastage of inventories; expected replacement of physical capital; and delinquency, aging, and default rates for loan portfolios. In addition, entities report information not required by a body that establishes GAAP, but required by laws or administrative directives. The laws or administrative directives may require the information to be audited and may require it to accompany basic information and RSI. However, this information is also considered OAI.

73G. Although the FASAB does not require OAI to be presented, the FASAB may at times encourage voluntary reporting of items to help in the development of information that may enhance overall federal financial reporting. For example, the FASAB may consider an item to be relevant to entity operations but, for the moment, does not meet other criteria for required information.

Table 1: Factors to Consider in Distinguishing Basic Information from RSI*

FACTORS TO CONSIDER IN DISTINGUISHING BASIC INFORMATION FROM RSI		
Low (implies RSI)	**Factor**	**High (implies Basic)**
	<Relevance to fair presentation>	
	<Connection with elements of financial reporting>	
	<Use of various types of financial data or financial transaction data>	
	<Level of importance the Board wishes to be communicated in the financial report>	
	<Significance, relevance, or importance of the item in light of *Objectives*>	
	< Level of importance the Board wishes to be communicated in the auditor's report>	
	<Relevance to measuring financial condition or changes in financial condition>	
	<Extent to which the information interests a wide audience (rather than specialists)>	
	<Extent to which there are not alternative sources of reliable information>	
	<Agreement on criteria that permit comparable and consistent reporting>	
	<Experience among users, preparers, and auditors with the information>	
	<Benefit/cost ratio of using resources to compile the information as well as ensure accuracy>	
	<Connection with basic financial statements>	
	<Reliability and/or precision possible>	
	<Reliability and/or precision needed>	

*As noted in paragraph 73D, the factors are not listed in a particular order and do not represent a hierarchy of factors.

Financial Reporting For An Organizational Entity

74. Meeting the four objectives of Federal financial reporting in the most efficient manner suggests that reporting entities issue a financial report that would include the following:

- management’s discussion and analysis;
- statement of financial position (commonly referred to as balance sheet);
- statement of net costs;
- statement of changes in net position;
- statement of custodial activities, when appropriate;
- statement of budgetary resources;
- budget and accrual reconciliation;[12.2]

[12.2]OMB will provide guidance regarding details of the display for the Budget and Accrual Reconciliation, including whether it should be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

- statement of program performance measures;[13]
- accompanying footnotes;
- required supplementary information; and
- other accompanying information.

75. With some organizations, and even suborganizations, the activities of one or more programs or other components are as important to the readers of the financial statements as are the activities of the entity as a whole. This would be particularly true for a Department composed of many bureaus, administrations, agencies, services, etc., and particularly if their programs are dissimilar. In those instances, consideration should be given to the preferability of reporting the assets, liabilities, revenues, expenses, etc. of both the significant components individually and of the entity in its entirety. Hence, larger organizations, and particularly those composed of many bureaus, administrations, agencies, etc., would prepare not only consolidated financial statements for the organizational entity, but also provideinformation pertaining to their individual significant components.[14] The information for the individual components could be provided with separate columns in consolidating financial statements[15] (with the information for the less significant components, and possibly the entity's management component, aggregated into a single separate column), in separate financial statements for each significant component, or in the accompanying footnotes. The significant components can be suborganizations or programs. If they are suborganizations, information regarding programs should be provided in some manner.

76. Furthermore, there are frequently instances when one or more of the suborganizations conduct a very visible or critical activity and there is a high level of public interest, e.g., tax collection activity; maintains large and complex fund flow activity; has earmarked tax activity; or its financial viability is of special concern to the Executive Branch or the Congress, e.g., deposit insurance funds. In those situations, it may be desirable for the sub-organization to prepare and issue a separate financial statement that is consistent with the

[13]The statement of program performance measures is not a basic financial statement. Nevertheless, it is an important component of the financial reports.

[14]Such components are similar to responsibility segments as referred to in SFFAS 4, *Managerial Cost Accounting Concepts and Standards,* par. 78-81. Responsibility segments are used to accumulate costs and outputs for major lines of activity.

[15]A **consolidated financial statement** presents the transactions and balances for a reporting entity's components in a single column. In arriving at the consolidated amounts, the transactions and balances among the entities are eliminated. A **consolidating financial statement** presents the information for the reporting entity's components as well as the consolidated amounts in individual columns. The elimination of the inter-entity transactions and balances needed to arrive at the consolidated amounts might or might not be presented in a separate column.

concepts presented in this concepts statement.[16] In doing so, it would need to identify the parent entity and describe the sub-organization's relationship to the parent.

77. The components of any reporting entity are likely to conduct transactions with other components in the reporting entity, other Federal entities, and persons and organizations outside the Federal Government. Likewise, they are likely to have assets due from and liabilities due to other Federal components and entities and to non-Federal persons and organizations. In reporting the transactions and balances of a Federal reporting entity in its entirety, it is conceptually desirable, although not always practicable, to eliminate the intra-entity transactions and balances.[17]

78. [Paragraph 78 was rescinded by SFFAS 47, *Reporting Entity*, paragraph 105.]

Financial Reporting For The Entire Government

79. In addition to budgetary integrity, operating performance, and systems and control information, readers of the financial statements for the entire government are likely to be concerned primarily with whether the government has been a proper steward. This can best be achieved with the preparation and issuance of the following:

- management's discussion and analysis;
- statement of financial position (commonly referred to as balance sheet);
- statement of net costs;
- statement of operations and changes in net position;
- reconciliation of net operating revenue (or cost) and unified budget surplus (or deficit);
- statement of changes in cash balance from unified budget and other activities;
- comparison of budgeted and actual use of resources;
- statement of program performance measures;
- accompanying footnotes;
- required supplementary information; and
- other accompanying information.

80. The readers should be made aware of whether the financial statements for the entire government exclude any significant entities that are included in the budget or include significant entities that are not included in the budget.

[16]Sub-organizations required by statute to prepare and issue a separate financial statement would, by definition, also need to do so.

[17][Rescinded by SFFAC 6.]

81. [Rescinded by SFFAC 6.]

82. The financial statements for the entire government could also be used to provide information on Presidential initiatives or crosscutting programs that is not available in financial statements for individual organizations or programs.

83. Because the government is a complete and integral economic entity, in contrast to the departments and major agencies whose components frequently have nothing in common other than belonging to the same department, it would be appropriate that the financial statement for the entire government be a consolidated financial statement. However, it might also be appropriate to display selected information for the components, funds, etc., either within the consolidated financial statement, in accompanying footnotes, and/or as supplemental information.

Recommended Contents For The Recommended Displays

Balance Sheet

84. The elements most likely to be presented in the balance sheet of a Federal suborganization/organization, program, or the entire government would be as follows:

- **Fund Balance with Treasury**. This represents the amount in the entity's accounts with the U.S. Treasury that is available only for the purposes for which the funds were appropriated. It may also include balances held by the entity in the capacity of a banker or agent for others. However, Fund Balance with Treasury (FBWT) meeting the definition of fiduciary FBWT should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities*.
- **Cash and other monetary assets**. Cash consists of coins, paper currency and readily negotiable instruments, such as money orders, checks, and bank drafts on hand or in transit for deposit, amounts on demand deposit with banks or other financial institutions, cash held in imprest funds, and foreign currencies.
- **Investments**. While Federal agencies have the authority to invest, they are typically limited to investing in securities issued by the Department of the Treasury or other Federal entities. There could be instances, however, when an agency owns property or securities issued by state or local governments, private corporations, or government sponsored enterprises, primarily for the purpose of obtaining a monetary return.
- **Receivables**. These are the amounts that the entity claims for payment from others. Receivables can result from such activities as the sales of goods or services, the non-

payment of taxes, the making of loans or loans assumed from defaults on previously made loan guarantees, the earning of interest, the advance or prepayment of monies, etc.

- **Inventories and related properties**. Inventories consist of tangible personal property held for sale, in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. Related properties that could be owned by a Federal program, suborganization or organization, or the entire government include operating materials and supplies, stockpile materials, seized property, forfeited property, and goods held under price support and stabilization programs.
- **Property, plant, and equipment**. Property, plant, and equipment (PP&E) have been defined in the Federal Government as tangible items owned by the Federal Government and having an expected useful life of greater than two years. Some PP&E are held by the Federal Government but not used to provide a service. They are in themselves a service. Examples are heritage assets such as monuments and museum collections; the service is the sense of tradition, understanding, and pride visitors receive visiting these sites. Information pertaining to these assets would not necessarily be displayed in the balance sheet, but rather as required supplemental information.[18]
- **Liabilities**. These are the amounts the reporting entity owes to others for goods or services received, progress in contract performance, defaulted guarantees, funds held as deposits etc. Because no liability can be paid without an enacted appropriation, some liabilities are funded while others are unfunded. Also, because the Federal Government is a sovereign entity, it can abrogate at any time many of its liabilities arising from other than contracts. This does not, however, eliminate the existence of, and therefore the need to report, liabilities incurred by the reporting entity.
- **Net position**. Net position is the residual difference between assets and liabilities. It is generally composed of unexpended appropriations and the cumulative results of operations. Included in the former would be appropriations not yet obligated or expended, including undelivered orders. Included in the latter would be the amounts accumulated over the years by the entity from its financing sources less its expenses and losses, which would include donated capital and transfers in the net investment of the Government in the reporting entity's assets; and an amount representing the entity's liabilities for such things as accrued leave, credit reform subsidies, and actuarial liabilities not covered by available budgetary resources.

[18]The Board issued an Exposure Draft, *Accounting for Property, Plant, and Equipment* (PP&E ED), on February 28, 1995 addressing those items of PP&E that would be reported on the balance sheet. The PP&E ED also proposes definitions for categories of PP&E that would not be reported on the balance sheet. In a separate ED, the Board will address other means of reporting on the non-balance sheet categories--possibly including separate basic financial statements and required supplemental information.

85. Assets the reporting entity holds and has the authority to use in its operations should be displayed separately from assets the entity holds but does not have the authority to use. Likewise, liabilities for which budgetary authority has been received for liquidating the liabilities should be displayed separately from liabilities for which budget authority has not been received (even if the authority is expected). Assets and liabilities arising from transactions among Federal entities should be displayed separately from assets and liabilities arising from transactions with non-Federal entities.

Statement Of Net Costs

86. The main purpose of a statement of net costs is to provide an understanding of the net costs of each organization and each program that the government supports with taxes and other unearned monies. Another important purpose for the statement is to provide gross and net cost information that can be related to the amounts of outputs and outcomes for the programs and/or organization. Thus the statement of net costs should present the amounts paid, the consumption of other assets, and the incurrence of liabilities as a result of rendering services, delivering or producing goods, or carrying out other operating activities.

87. The costs can be classified in a reporting entity's statement of net costs by sub-organization (assuming the reporting entity is an organization), by program, or by object class, or any combination thereof. Object class, also referred to as a "natural" classification, represents the nature or types of goods or services acquired without regard to the organization involved or the program for which they were used. Reporting of the sub-organization incurring the costs and/or the purposes for which the costs were incurred generally provides more useful information than reporting on the types of goods or services acquired.

88. The statement of net costs should also present the revenues earned by each program and organization. The manner in which the earned revenues would be presented would depend on the purpose of the program and the reasons why the revenues are present.

89. Some programs are established with generation of revenue as a primary consideration or purpose. One example would be when the goods or services provided by the organization are also available from the private sector and not charging a fee for the goods or services would be unfair competition. Another example would be when it is deemed appropriate that the persons or organizations receiving the goods or service pay for the goods or services, usually to be able to ascertain the true cost of the activity using the goods or services, e.g., the Defense Business Operations Fund, Postal Service. Still another example is when revenues are imposed to limit the unnecessary consumption of the goods or services. In each of these instances, the revenues earned by the program(s) should be considered a deduction from the total costs of the program(s).

90. With other programs, the revenues are generated from administering an inherently governmental service, which means the revenues are not a primary consideration for the program. Rather, the revenues are a means to recover all or most of the costs of administering the program, e.g., the Securities and Exchange Commission. In those instances, the revenues should be considered a deduction from the total costs of the organization, not the program.

91. In still other instances, an organization’s revenues can be generated by providing a specific program, but the revenues are not a primary consideration in the conduct of the program; they are incidental to the purpose of the program, e.g., the sale of maps by the Geological Survey. In those instances, it would be appropriate to consider the earned revenues as a deduction from the incremental costs that need to be incurred in order to provide the goods or services that generate the incidental revenues, to the extent that the incremental costs are measurable and relevant to decision making. Otherwise the revenues should be considered a deduction from the program’s or organization’s total costs.

92. Earned revenues that are insignificant in amount can be netted into the costs of the programs with the amounts disclosed in accompanying footnotes, if appropriate.

93. An organization or sub-organization could receive different types of revenues for different purposes and/or reasons. Each of the revenues and associated costs would be displayed in accordance with the concepts presented in paragraphs 89 through 92.

94. The costs associated with and displayed for each program should reflect costs that can be directly traced to the program, assigned to the program based on cause and effect, or allocated to the program on a reasonable and consistent basis, consistent with the premise that any costs reported for a program should be controllable by the program to at least some degree. Those costs that are not directly traceable, assignable, or allocable could be considered program or management support costs that are incurred by the reporting organization or another organization to administer the reporting organization’s or program’s activities. For example, in a reporting entity that provides social services, the program costs would be the cash payments and the salary and other costs, e.g., rent, supplies, directly associated with persons providing counseling to the recipients of the cash payments. The organizational support costs would be the costs of the organizational structure required to administer the organization, i.e., not directly attributable to the programs provided by the organization.

95. Organizational and program management costs are necessary costs of operating an organization and programs. Not displaying these costs because of a belief that an allocation for these activities would be eliminated or reduced in order to obtain a reduction of the cost of the entire organization or program is illogical. The alternative concept, which is burying the management costs with the program costs, increases the likelihood that the

management activity will be subject to reductions imposed on the program delivery activities. Separately identifying the management costs enables the use of resources for these activities to be justified on their own merit. The costs for managing the organization and/or program can therefore be displayed on the face of the financial statements or in accompanying footnotes, particularly when it would assist in evaluating operating performance and is cost-effective. Disclosure of what the support costs entail would be appropriate.

96. The total costs displayed in a reporting entity's financial statements should be the same as the total costs recorded by an organization in its cost accounting system. If, for financial reporting purposes, the organization does not allocate organizational management costs among the programs, the total costs displayed for any one program in the entity's financial statements could be different than the costs recorded for that program in the cost accounting system.

97. Other earned revenues would include revenues not attributable to a specific program.

98. Costs and revenues arising from transactions with other Federal entities should be displayed separately from transactions with non-Federal entities.

99. The decision as to how to display total program costs, earned revenues, net program costs, and organizational and program management costs should be based, in part, on a consideration of what the Congress, management, and others might want to know about the costs of providing an organization's programs.

Statement Of Changes In Net Position

100. The appropriate elements for a statement of changes in net position would be as follows:

- **Net costs** display the amount that had to be financed by other than earned revenues.
- **Appropriations used** represent the amount of budget authority, including transferred budget authority, used by the organization to finance its operations.
- **Non-exchange revenues** include dedicated taxes, fines, and other revenues the Government is able to obtain due to its sovereign powers.
- **Donations** are monies and materials given by private persons and organizations to the Government without receiving anything in exchange.
- **Transfers in** are amounts of cash or other capitalized assets received by one Government entity from another Government entity without reimbursement.
- **Transfers out** are amounts of cash or other capitalized assets provided by one Government entity to another without reimbursement.

- **Imputed financing sources** are of two types: amounts equal to the costs that have been incurred by the reporting entity but financed by another entity, e.g., retirement costs; and amounts representing costs that are attributable to the reporting entity's activities but that do not require a direct out-of-pocket payment, e.g., the interest costs associated with carrying inventory or investing in physical assets.[19]
- **Prior period adjustments** are corrections of prior period results of operations.
- **Increase (decrease) in unexpended appropriations** is the change in appropriated capital, including transferred budgetary resources, that does not affect the net cost of operations but does affect net position.
- **Net position-beginning of the period** is the total unexpended appropriations and cumulative results of operations held by the entity at the beginning of the reporting period.
- **Net position-end of the period** results from adding and netting the various amounts associated with the operations of the entity during the reporting period, including the net position-beginning of the period and any prior period adjustments. The amount will thus equal the total unexpended appropriations and cumulative results of operations held by the entity at the end of the period.

Statement Of Custodial Activities

101. A separate statement of custodial activities would be appropriate for those entities whose primary mission is collecting taxes or other revenues, particularly sovereign revenues that are intended to finance the entire Government's operations, or at least the programs of other entities, rather than their own activities. The revenues should be characterized by those agencies as custodial revenues. The statement should display the sources and amounts of the collections of custodial revenues, any increases or decreases in amounts collectable but not collected, the disposition of the collections through transfers to other entities, the amounts retained by the collecting entity, and any increase or decrease in the amounts to be transferred.

102. Custodial collections do not include deposit funds, i.e., amounts held temporarily by the government (e.g., bidders' earnest money or guarantees for performance) or amounts held by the Government as an agent for others, (e.g., state income taxes withheld from Federal employees' salaries that are to be transferred to the states). These types of collections should be reported in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities*.

[19]The Board plans to undertake a project on the interest cost associated with investing in operating assets. At this time, no decision has been made on the recognition by individual entities of these types of costs.

103. Organizations that collect custodial revenues that are incidental to their primary mission do not need to report the collections and disposition of these revenues in a separate statement. The disclosure of the sources and amounts of the collections and the amounts distributed to others could be disclosed in accompanying footnotes.

Statement Of Budgetary Resources

104. The appropriate elements for a statement of budgetary resources prepared for a reporting entity would be as follows:

- **Budgetary resources made available** is the amount available to enter into obligations that will result in immediate or future outlays involving Federal Government funds. The resources should be relevant to the reporting period. The components of budgetary resources would include budget authority (i.e., appropriations, borrowing authority, and contract authority) and unobligated balances of multi-year and no-year money remaining from prior reporting periods. Budgetary resources would also include reimbursements and other income (i.e., spending authority from offsetting collections credited to an appropriation or fund account) and adjustments (e.g., recoveries of prior year obligations).
- **Status of Budgetary Resources** displays the disposition of the budgetary resources made available. It consists of the obligations incurred; the unobligated balances of multi-year and no-year budget authority that are available; and the unobligated balances of one-year and multi-year lapsed budget authority that are not available, but have been carried forward to be used only to record, adjust, or liquidate obligations chargeable to the appropriation. The total amount displayed for status should be equal to the total amount displayed as being made available.
- **Outlays** are payments to liquidate obligations, net of offsetting collections. Obligations are usually liquidated by means of cash payments (currency, checks, or electronic funds transfers), but in certain cases obligations are liquidated and outlays recorded even though no cash is disbursed. It would be appropriate, in displaying outlay information, to tie it to the obligations incurred by also displaying the transfers of obligations and the obligated balances at the beginning and end of the period.

105. Budgetary resources, obligations, outlays, and receipts are reported in the Treasury's Annual Report and Monthly Treasury Statement and in the President's Budget, although not all these publications report all these measures. These documents are usually issued prior to the issuance of financial statements prepared in accordance with generally accepted accounting principles applicable to the Federal Government. In preparing these statements, significant differences should be noted between amounts reported in the former documents and amounts reported in the subsequently prepared financial statements. Such differences should be adjusted in the records of the reporting entity and in the related records

maintained by the central agencies, and the correct amounts reported in the financial statements. It would also be desirable to provide a reconciliation for significant differences appearing in the two types of statements.

Budget and Accrual Reconciliation

105A. The purpose of the reconciliation of Net Costs to Outlays is to explain how budgetary resources outlayed during the period relate to the net cost of operations for the reporting entity. This information should be presented in a way that clarifies the relationship between the outlays reported through budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship, the reconciliation provides the information necessary to understand how the budgetary outlays finance the net cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the reconciliation are indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from outlays to net cost of operations.

105B. **Net Cost of Operations** is from the Statement of Net Cost.

105C. **Components of net cost that are not part of net outlays** are most commonly (a) 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), (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period, and (c) costs financed by other entities (imputed inter-entity costs).

105D. **Components of net outlays that are not part of net cost** are primarily amounts provided in the current reporting period that fund costs incurred in prior years and amounts incurred for goods or services that have been capitalized on the balance sheet (e.g., plant, property and equipment acquisition and inventory acquisition).

105E. **Other temporary timing differences** reflect special adjustments (e.g., prior period adjustments due to correction of errors).

105F. **Net Outlays** is the summation of the above amounts and equals the Statement of Budgetary Resources net outlays amount.

105G. The preparer should present material amounts separately in the reconciliation and discuss these in the narrative. The use of “other” captions should be minimized and individually material amounts should not be netted to report an immaterial amount.

Statement Of Program Performance Measures

106. The statement of program performance measures should include measures for each of the major programs the reporting entity operates. The preferred types of measures are (1) output measures, i.e., the quantity of a service or product provided or the percentage of the target group provided the service or product, and that ideally meets a certain quality requirement; and (2) outcome measures, i.e., the accomplishments or results that occurred because of the services or outcomes provided. Outcome measures could address either the ultimate program outcome or intermediate outcomes, e.g., accuracy of, timeliness of, or satisfaction with the services provided. Workload, process, and input measures should be in the minority. Explanatory information that helps the readers understand the reported measures, assess the entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance is appropriate. Comparative measures from prior years or similar programs and industry standards are also appropriate. They help to provide a better understanding of the level of the reporting entity's performance.[20]

107. The measures selected for reporting should relate to the programs' purposes and goals. It would be particularly useful to include measures previously included in budget documents and other materials released to the public. It would also be useful to base the selection of measures on discussions with budget examiners, Congressional staffs, and other users of the entity's financial statements.

108. The statement of program performance measures should not be cluttered with trivial measures. Measures selected should be considered important by decisionmakers and particularly the resource providers that are likely to use the financial statements. Also, relevant measures should be reported, without regard to whether they portray positive or negative performance. The most significant measures should be extracted for highlighting in the management's discussion and analysis.

109. Other characteristics to consider for reporting program performance measures are as follows:

[20]The acceptance of a statement of program performance will increase in relation to the users' perception of the relevance and reliability of the reported information. These perceptions can be enhanced to the extent there are independent assessments of the appropriateness of the measures, the completeness of the data, the actual occurrence of the reported events, and the values assigned to the data. Auditors of Federal agency financial statements are currently required (by an OMB Bulletin) to evaluate the underlying control structure for program performance measures included with the financial statements. The extent to which auditors will be expected to expand the scope of their involvement with program performance measures to include the aforementioned independent assessments would be specified by OMB consistent with government audit standards.

- **Completeness**. The measures, in the aggregate, should cover all aspects of the reporting entity's mission.
- **Legitimacy**. The measures should be accepted as relevant both inside the reporting entity and by the external stakeholders and others, e.g., the central management agencies, Congress, interest groups, the public.
- **Understandability**. The measures should communicate the performance of the entity in a readily understandable manner to any reasonably informed and interested party.
- **Comparability**. The measures should provide a frame of reference for assessing, and comparing, if appropriate, the performance of the entity and entities with similar programs for both the immediate period and over time.
- **Ability to relate to cost**. The measures should be such that a cost can be defined for each unit of output, outcome, input, etc.
- **Timeliness**. The measures should be available to users of the financial statements before they lose their capacity to be of value in assessing accountability and making decisions. The value of timeliness should not preclude the use of important measures for which results are not immediately available.
- **Consistency**. The measures should be reported consistently from period to period to allow users to have a basis for comparison and to gain an understanding of the measures being used and their meaning (recognizing that the measures should be reviewed regularly and modifications made to reflect changing circumstances).
- **Reliability**. The information should be derived from systems that produce controlled and verifiable data, although at times it may be necessary to rely on secondary sources of data.[21]

110. Since many Federal Government programs have counterpart programs at the state and local government level, for those programs, it would also be appropriate to consider the measures states and local governments use to report performance.

111. Numerical measures are not the only way to report program performance. In some instances, it may be more meaningful and practicable to report performance with other than numerical measures.

112. Example formats for displaying the recommended elements are provided in appendix 1. These formats are illustrative and provided solely to help readers of this document better understand the recommended concepts for displaying financial and related information. In

[21]The Public Management Committee of the Organization for Economic Cooperation and Development, which is comprised of the twenty four democratic nations with advanced market economies, has been studying performance management systems. It has concluded, based on the experiences of countries that have implemented such systems, that performance measures should reflect three important characteristics: validity, continuity, and legitimacy. These characteristics, while intended to guide management systems in their totality, rather than simply inclusion in financial statements, have nonetheless been incorporated into the above characteristics.

exposing proposed standards, the Board might portray other formats. The ultimate specification of the form and content for financial statements for Federal agencies is defined by OMB.

Appendix 1-A: Balance Sheet

Example Financial Statement Formats

BALANCE SHEET - as of September 30, 19X4 - ASSETS

	Suborganization A	Suborganization B	Suborganization C	Total FY 19X4	Total FY 19X3
Entity assets:					
Fund balance with Treasury	$xxx	$xxx	$xxx	$xxx	$xxx
Cash (and other monetary assets)	xxx	xxx	xxx	xxx	xxx
Investments:					
Intragovernmental	xxx	---	xxx	xxx	xxx
With the public	xxx	xxx	xxx	xxx	xxx
Receivables:					
Intragovernmental	xxx	xxx	xxx	xxx	xxx
With the public	xxx	---	xxx	xxx	xxx
Inventories and related properties	xxx	xxx	xxx	xxx	xxx
Physical assets	xxx	xxx	xxx	xxx	xxx
Total entity assets	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Non-entity assets:					
Fund balance with Treasury	xxx	xxx	xxx	xxx	xxx
Cash	xxx	xxx	xxx	xxx	xxx
Receivables:					
Intragovernmental	xxx	xxx	xxx	xxx	xxx
With the public	xxx	xxx	xxx	xxx	xxx
Total non-entity assets	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Total assets	**$xxx**	**$xxx**	**$xxx**	**$xxx**	**$xxx**

BALANCE SHEET - as of September 30, 19X4 - LIABILITIES AND NET POSITION

	Suborganization A	Suborganization B	Suborganization C	Total FY 19X4	Total FY 19X3
LIABILITIES					
Liabilities covered by budgetary resources:					
Intragovernmental liabilities:					
Payables	$xxx	$xxx	$xxx	$xxx	$xxx
Governmental liabilities:					
Payables	xxx	xxx	xxx	xxx	xxx
Total liabilities covered by budgetary resources	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Liabilities not covered by budgetary resources:					
Intragovernmental liabilities:					
Payables	xxx	xxx	xxx	xxx	xxx
Governmental liabilities:					
Payables	xxx	xxx	xxx	xxx	xxx
Amounts held for others	xxx	---	xxx	xxx	xxx
Total liabilities not covered by budgetary resources	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Total liabilities	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
NET POSITION					
Unexpended appropriations	xxx	xxx	xxx	xxx	xxx
Cumulative results of operations	xxx	xxx	xxx	xxx	xxx
Total net position	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Total liabilities and net position	**$xxx**	**$xxx**	**$xxx**	**$xxx**	**$xxx**

Note: The above balance sheet format is for an organization composed of three significant suborganizations. An organization deciding to forego presenting the information pertaining to the suborganizations would provide only the information contained in the last two columns.

Appendix 1-B: Statement of Net Costs

Example Financial Statement Formats

STATEMENT OF NET COSTS - For the year ended September 30, 19X4

	Suborganization A	Suborganization B	Suborganization C	Total FY 19X4	Total FY 19X3
COSTS:					
Program A:					
Intragovernmental	$xxx	$---	$---	$xxx	$xxx
With the public	xxx	---	---	---	---
Total	xxx	---	---	---	---
Less earned revenues	xxx	---	---	xxx	---
Net program costs	**xxx**	**---**	**---**	**xxx**	**xxx**
Program B:					
With the public	---	xxx	xxx	xxx	xxx
Less earned revenues	---	xxx	xxx	xxx	xxx
Net program costs	**---**	**xxx**	**xxx**	**xxx**	**xxx**
Program C:					
Intragovernmental	xxx	xxx	---	xxx	xxx
With the public	xxx	xxx	---	xxx	xxx
Net program costs	**xxx**	**xxx**	**---**	**xxx**	**xxx**
Program D:					
Costs with the public	---	xxx	---	xxx	xxx
Cost not allocated to programs	xxx	xxx	xxx	xxx	xxx
Less other earned revenues	**---**	**---**	**xxx**	**xxx**	**xxx**
NET COST OF OPERATIONS	**$xxx**	**$xxx**	**$xxx**	**$xxx**	**$xxx**

Appendix 1-C: Statement of Changes in Net Position

Example Financial Statement Formats

STATEMENT OF CHANGES IN NET POSITION - For the year ended September 30, 19X4

	Suborganization A	Suborganization B	Suborganization C	Total FY 19X4	Total FY 19X3
NET COST OF OPERATIONS	**$(xxx)**	**$(xxx)**	**$(xxx)**	**$(xxx)**	**$(xxx)**
FINANCING SOURCES					
Appropriations Used	xxx	xxx	xxx	xxx	xxx
Taxes (non-exchange revenue)	xxx	xxx	xxx	xxx	xxx
Donations (non-exchange revenue)	---	xxx	xxx	xxx	xxx
Imputed Financing	xxx	xxx	xxx	xxx	xxx
Transfers-in	xxx	---	xxx	xxx	xxx
Transfers-out	---	(xxx)	---	(xxx)	---
NET RESULTS OF OPERATIONS	xxx	xxx	xxx	xxx	xxx
PRIOR PERIOD ADJUSTMENTS	xxx	xxx	---	xxx	xxx
NET CHANGE IN CUMULATIVE RESULTS OF OPERATIONS	xxx	xxx	xxx	xxx	xxx
INCREASE (DECREASE) IN UNEXPENDED APPROPRIATIONS	xxx	(xxx)	xxx	xxx	xxx
CHANGE IN NET POSITION	xxx	xxx	xxx	xxx	xxx
NET POSITION-BEGINNING OF PERIOD	xxx	xxx	xxx	xxx	xxx
NET POSITION-END OF PERIOD	**$xxx**	**$xxx**	**$xxx**	**$xxx**	**$xxx**

Note: The above statement of changes in net position format is for an organization comprised of three significant suborganizations. An organization deciding to forego presenting the information pertaining to the suborganizations would provide only the information contained in the last two columns.

Appendix 1-D: Statement of Custodial Activities

Example Financial Statement Formats

STATEMENT OF CUSTODIAL ACTIVITIES - For the year ended September 30, 19X4

	FY 19X4	FY 19X3
Collections:		
Income Taxes	**$(xxx)**	**$(xxx)**
Estate and gift taxes	xxx	xxx
Excise Taxes	xxx	xxx
Employment Taxes	xxx	xxx
Penalties and Interest	xxx	xxx
Total collections	**xxx**	**xxx**
Refunds and other payments	(xxx)	(xxx)
Net collections	xxx	xxx
Accrual adjustment	xxx	(xxx)
Total revenues collected	**xxx**	**xxx**
Disposition of revenues collected:		
Transferred to others:		
Department of the Treasury	xxx	xxx
Department of Labor	xxx	xxx
Environmental Protection Agency	xxx	xxx
Total transfers	xxx	xxx
Retained by the entity	xxx	xxx
Increase (decrease) in amounts to be transferred	xxx	(xxx)
Total disposition of revenues collected	**xxx**	**xxx**
Net custodial collections	**$000**	**$000**

Appendix 1-E: Statement of Budgetary Resources

Example Financial Statement Formats

STATEMENT OF BUDGETARY RESOURCES - For the year ended September 30, 19X4

	Suborganization A	Suborganization B	Suborganization C	Total FY 19X4	Total FY 19X3
Budgetary resources made available:					
Budget authority	$xxx	$xxx	$xxx	$xxx	$xxx
Unobligated balances-beginning of period	xxx	xxx	xxx	xxx	xxx
Reimbursements and other income	xxx	xxx	xxx	xxx	xxx
Adjustments	xxx	xxx	xxx	xxx	xxx
Total, budgetary resources made available	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Status of budgetary resources:					
Obligations incurred (gross)	xxx	xxx	xxx	xxx	xxx
Unobligated balances-end of period	xxx	xxx	xxx	xxx	xxx
Unobligated balances-not available	xxx	xxx	xxx	xxx	xxx
Total, status of budgetary resources	**xxx**	**xxx**	**xxx**	**xxx**	**xxx**
Outlays					
Obligations incurred, net	xxx	xxx	xxx	xxx	xxx
Obligations balance transferred	xxx	xxx	xxx	xxx	xxx
Obligations balance-beginning of period	xxx	xxx	xxx	xxx	xxx
Less: obligations balance-end of period	xxx	xxx	xxx	xxx	xxx
Total, outlays	**$xxx**	**$xxx**	**$xxx**	**$xxx**	**$xxx**

Appendix 1-F: Statement of Program Performance Measures

Example Financial Statement Formats

Statement of Program Performance Measures[22]- For the year ended September 30, 19X4

	FY 19X4	FY 19X3	FY 19X2
Sub-organization A			
Program			
Performance Measure	xxx	xxx	xxx
Performance Measure	xxx	xxx	xxx
Program			
Performance Measure	xx%	xx%	xx%
Performance Measure	xxx	xxx	xxx
Program			
Performance Measure	xxx	xxx	xxx
Performance Measure	xx%	xx%	xx%
Sub-organization B			
Program			
Performance Measure	xxx	xxx	xxx
Performance Measure	xx%	xx%	xx%
Program			
Performance Measure	xx%	xx%	xx%
Performance Measure	xxx	xxx	xxx
Sub-organization C			
Program			
Performance Measure	xxx	xxx	xxx
Performance Measure	xx%	xx%	xx%

Note: Sub-organizations A, B, and C are equivalent to responsibility segments for which cost and financial data are collected. (See FASAB Exposure Draft, “Managerial Cost Accounting for Federal Government”, pages 26-30.)

[22] Although this example contains only numerical measures, the performance for some programs might be reported with other than numerical measures.

Appendix 1-G: Entity and Display

EXAMPLE FINANCIAL STATEMENT FORMATS – BUDGET AND ACCURAL RECONCILIAITON

NARRATIVE

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis below illustrates this reconciliation by listing the key differences between net cost and net outlays.

Unrealized valuation loss on investment in the reconciliation is related to the write down of security investment due to recent market volatility, which did not result in an outlay but did result in a cost. The large increase of accounts payable compared to last year is because this year's rent expense has not been paid but was included in the net cost this year and not included in the outlays. The large variance in the "transfers in/(out) without reimbursement" between fiscal year (FY) 201X and FY201X is primarily due to the transfer of program management responsibility from agency 1 to agency 2 as discussed in further detail in Note X. In addition, the decrease in "Imputed financing source" is a result of the payment in FY201X for the ABC Settlement.[*]

[*] This is an illustration of what might be presented in the narrative paragraph. It is an example of how to explain the material line items in the reconciliation and describes why some material line items either increase or decrease net cost but do not have the same impact on net outlays.

RECONCILIATION EXAMPLE

For the year ended September 30, 201X

	Intra-governmental	With the public	Total FY 201X
NET COST	**$xxx**	**$xxx**	**$xxx**
Components of Net Cost That Are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	xxx	xxx	xxx
Property, plant, and equipment disposal & revaluation	xxx	xxx	xxx
Year-end credit reform subsidy re-estimates	xxx	xxx	xxx
Unrealized valuation loss/(gain) on investments	xxx	xxx	xxx
Increase/(decrease) in assets:			
Accounts receivable	xxx	xxx	xxx
Loans receivable	xxx	xxx	xxx
Investments	xxx	xxx	xxx
Other assets	xxx	xxx	xxx
(Increase)/decrease in liabilities:			
Accounts payable	xxx	xxx	xxx
Salaries and benefits	xxx	xxx	xxx
Insurance and guarantee program liabilities	xxx	xxx	xxx
Environmental and disposal liabilities	xxx	xxx	xxx
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	xxx	xxx	xxx
Other financing sources:	xxx	xxx	xxx
Federal employee retirement benefit costs paid by OPM and imputed to the agency	xxx	xxx	xxx
Transfers out (in) without reimbursement	xxx	xxx	xxx
Other imputed financing	xxx	xxx	xxx
Total Components of Net Cost That Are Not Part of Net Outlays	**xxx**	**xxx**	**xxx**
Components of Net Outlays That Are Not Part of Net Cost:			
Effect of prior year agencies credit reform subsidy re-estimates	xxx	xxx	xxx
Acquisition of capital assets	xxx	xxx	xxx

	Intra-governmental	With the public	Total FY 201X
Acquisition of inventory	xxx	xxx	xxx
Acquisition of other assets	xxx	xxx	xxx
Other	xxx	xxx	xxx
Total Components of Net Outlays That Are Not Part of Net Cost	**xxx**	**xxx**	**xxx**
Other Temporary Timing Differences	**xxx**	**xxx**	**xxx**
NET OUTLAYS	**$xxx**	**$xxx**	**$xxx**[23]

[23]Total Net Outlays can be linked to the Statement of Budgetary Resources, and equals gross outlays less actual offsetting collections and distributed offsetting receipts. The net outlays for Intra-governmental and With the Public listed in the format are calculated totals.

Appendix 2: List of Acronyms

See Consolidated List of Acronyms in “Appendix F: Consolidated List of Abbreviations”

Statement of Federal Financial Accounting Concepts 3: Management's Discussion and Analysis

Status

Issued	June 8, 1999
Affects	SFFAC 1, paragraph 181, by providing guidance on MD&A
Affected by	SFFAS 27, paragraph 39, amends paragraph 26 SFFAC 9, amends paragraph 26 footnote 10

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

This document describes the concepts on which the Board relied in recommending standards for Management's Discussion and Analysis (MD&A) to be included in general purpose federal financial reports (GPFFR).[1] Concepts Statements are not authoritative in the sense that they do not establish standards or principles. Preparers may find them useful, but these concepts are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the *Codification of Statements on Auditing Standards* published by the American Institute of Certified Public Accountants. No standards or prescribed guidelines for MD&A are presented in this statement of concepts.

MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the GPFFR, and (3) providing 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.

[1] The term general purpose 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 pursuant to federal accounting principles.

A separate document titled *Standards for Management's Discussion and Analysis* presents the standards for MD&A. The standards for MD&A say that 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 possible 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 require MD&A to be included in each GPFFR as required supplementary information (RSI).

Table of Contents

Statement Of Concepts

Basic Concept

1. Each general purpose federal financial report (GPFFR, see figure 1 on 7) should include a section devoted to management's discussion and analysis (MD&A).[1] MD&A should address the reporting entity's program and financial 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.

Discussion and Rationale

2. A typical GPFFR is a highly summarized profile of a complex entity. It is based on conditions that exist at the reporting date and events that occurred in the preceding period. It shows what has happened, but it does not explain why it happened or what may reasonably be expected to happen in the future.

3. Financial reports have two key roles. One is a feedback role to provide information used for evaluating past decisions, expectations, and trends. Another is a predictive role to provide information used for formulating expectations and making decisions about the future. Both roles can be enhanced by insights and interpretations from an entity's management.

4. The managers of an entity have detailed knowledge of the transactions, events, and conditions reflected in the entity's financial report and of the policies that govern the entity's operations. The managers also have informed expectations regarding the future based on that knowledge. As a part of their stewardship responsibility, managers should explain the significance of key financial and nonfinancial information shown in the report, the strategies

[1]The 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. For more information on the "Accountability Report" see paragraph 59 and the glossary. (Other words defined in the glossary are marked with an asterisk.) See also *Toward a Report to Citizens on the State of their Nation and the Performance of Their Government: proceedings of the AGA Task Force on a Report to Citizens on the State of the Nation*, Association of Government Accountants, 1994.

that led to the results reported, and the implications for future operations of events that have occurred or are likely to occur. The distinction between "financial" and "nonfinancial" information is arbitrary and often tenuous, but in this context "nonfinancial information" can include information on systems, controls, compliance with laws and regulations, and performance.

5. A Federal reporting entity's GPFFR should be understandable and useful to a wide audience, not just members of the entity's management and specialized analysts working for special interest groups, corporations, and other entities affected by the Government's actions. Therefore, the report should be accompanied by a concise narrative discussion and analysis. Even insiders and specialized analysts often need such a discussion and analysis to understand the report. Communication with a wide audience may require effective use of colors, graphs, photographs, and charts. Reporting understandable, accessible information on the Government's actions and the effects of its actions helps assure accountability and provides a more "level playing field" on which the public interest can best be served.

Background

6. The Securities and Exchange Commission (SEC) has for many years recognized the importance of such a narrative discussion of the financial statements. To serve the interests of investors and creditors, the SEC requires such a narrative discussion and analysis from management of companies under its purview. The SEC wants MD&A to help readers understand the entity's financial position and results of operations with the benefit of management's understanding and perspective. The SEC also wants MD&A to go beyond the basic financial statements, to include relevant forward-looking information. Research on MD&A for companies registered with the SEC shows that MD&A adds value to the financial statements. Forward-looking information, for example, can be an important contribution.[2]

7. Several factors suggest that MD&A may be even **more** important for Federal reporting entities than for those in the private sector and may need to be more extensive in scope. These factors include the complexity of Federal operations, the myriad objectives they pursue, and the diverse nature of the groups affected by and interested in the Government's activities. Fundamentally, the Government's objective is to provide for the common defense and to promote the general welfare, not to earn a profit. Therefore, reporting on performance and other matters in a way that is understandable to diverse audiences is

[2]Research on MD&A in private sector financial reporting suggests that forward-looking information in MD&A, in particular, is a significant source of added value for financial analysts. See Stephen H. Bryan, "Incremental Information Content of Required Disclosures Contained in Management Discussion and Analysis," *The Accounting Review* Vol. 72 No. 2, (April 1997), pp. 285-301.

important. For these reasons, both SFFAC 1, *Objectives of Federal Financial Reporting*, and SFFAC 2, *Entity and Display*, refer to MD&A in concept as part of the general purpose federal financial report.

8. Page 7 presents a schematic diagram of a sample GPFFR. It is schematic because the information called for by the statements of federal financial accounting standards should be located in the report in a logical sequence, not necessarily in the order shown. MD&A for the reporting entity as a whole normally will be located immediately after the agency head's letter. Reporting entities that organize their GPFFR by responsibility segment may combine MD&A regarding each segment; alternatively, they may have MD&A for each responsibility segment located separately in each of the respective subsections of the report. Preparers have flexibility to structure their report in the manner most appropriate under the circumstances. This diagram, the entire statement of concepts, and the accompanying standards for MD&A are intentionally written in general terms, in light of the evolving practice of performance reporting and accountability reporting in the federal government. The standards for MD&A define in general terms required supplementary information that should accompany financial statements prepared in conformance with federal accounting principles.

FIGURE 1: Schematic Diagram of a Sample General Purpose Federal Financial Report

Agency Head's Letter					
Management's Discussion and Analysis (RSI)					
<----- Other Elements of the General Purpose Federal Financial Report ----->					
1. Basic financial statements and notes, with auditor's report if audited	2. Required Supplementary Stewardship Information (RSSI)	3. Required Supplementary Information (RSI)	4. Performance Information	5. Other Accompanying Information (OAI)	6. Management's assertions and reports on controls, compliance, and corrective actions under FMFIA and FFMIA (or portions of these assertions and reports)

The GPFFR is represented by MD&A plus columns 1-6 of the diagram. (The agency head's letter is part of the GPFFR by general practice, though it is not required by federal accounting principles.) This is not a literal depiction of the organization of a report. Information should be presented in a logical arrangement. MD&A will address major issues that are typically reported in more detail in the discrete sections of the GPFFR or in other publicly available reports that the GPFFR incorporates by reference. Incorporating another report by reference does not, by itself, mean that the separate report is subject to audit.

Unless law or managerial action requires more extensive audit review or examination of the material incorporated by reference, the FASAB expects that the auditor of the financial statements will treat the material incorporated by reference as other accompanying information, although it does not physically accompany the GPFFR. OMB has authority to provide specific guidance on the auditor's minimum responsibility regarding this material. OMB may, for example, direct auditors to treat the material incorporated by reference as if it were other accompanying information in an auditor-submitted document.

SFFAC 2 (paragraphs 106-111 and Appendix 1-F) calls for a "Statement of Performance Measures" as part of the GPFFR, but FASAB has not yet recommended standards for it. Other titles may be used for this section of the GPFFR. Performance indicators included in the GPFFR will either be those in the entity's annual performance report under the Government Performance and Results Act of 1993 (GPRA or the Results Act) or a subset of them.

Alternatively, that report may be incorporated by reference. Until further guidance is available, the agency should select the indicators to report in consultation with OMB.

The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFFR or incorporated in the GPFFR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. "Highly important" in this context may imply a higher threshold than "materiality" for the financial statements.

If the report also includes financial statements for component entities (bureaus, responsibility segments, etc.), management should use its judgment in organizing the report. The component entities' financial statements may be discussed in separate sections of the report or as subsections of MD&A of the consolidated entity.

9. MD&A should address:

- the entity's structure, mission, goals, and objectives, with indicators[3] of its performance;
- actions taken or planned to improve performance, when appropriate;
- the financial statements;
- systems, internal controls*[4] and legal compliance, including corrective action taken or planned; and
- the future effects of existing, currently- known demands, risks, uncertainties, events, conditions and trends. MD&A may also address the possible future effects of anticipated* future demands, events, conditions, trends, etc. that management believes would be important to the reader of the report.

10. MD&A should address these subjects even if, as will be true for many Federal reporting entities, separate documents report much of the information in more detail. Information about these subjects is essential to address the objectives of federal financial reporting regarding performance, stewardship, budgetary integrity, and systems and controls.

    The following paragraphs explain the implications of this.

11. Regarding the entity's mission and performance, MD&A should inform the reader how well the reporting entity is doing. This means that it should tell the reader what the reporting entity and its programs have accomplished, and how well the entity is managing its programs. To do this, MD&A should answer such questions as:

- What do we need to know to gauge operating success?
- How do we measure what we accomplished?
- What do the measurements show?

12. To understand the information on performance, systems, controls, and legal compliance, it typically is necessary to understand something about the reporting entity's organizational structure, mission, and strategic plan. Accordingly, MD&A should concisely inform the reader about these topics.

13. Reporting information that helps people assess the performance of the Government's programs and organizations is an important objective of Federal financial reporting. For

[3]This document uses the terms "performance measure" and "performance indicator" synonymously. Some people use the term "performance indicator" instead of "performance measure" because the performance of government programs typically involves several factors or dimensions, and many of these dimensions of performance cannot be measured precisely.

[4]Words marked with * are defined in the glossary.

governmental entities, in contrast to profit-seeking entities, the financial result of governmental-type activities is rarely an adequate indicator of performance. (For a few governmental entities, mainly those that conduct primarily business-type instead of governmental-type activities, the financial results of operations may be an important, albeit rarely sufficient, performance indicator.) To assess performance, people need additional information on the consequences of the Government's activities. For a competitive, profit-seeking entity, the value of its products or services is measured by the amount of money customers are willing voluntarily to pay for them. In such a situation, the traditional income statement reports on both the efforts (measured by expenses incurred) and the accomplishments (measured by revenue earned) of the entity. For government, expense reflects efforts, as it does in the private sector, but indicators other than revenue must be used to report on accomplishments. A discrete section of the GPFFR therefore presents indicators of accomplishments (such as indicators of outputs and outcomes) and other indicators of performance. Alternatively, the GPFFR incorporates performance indicators by reference to a separate report such as the Annual Performance Report required by the Results Act. Either way, performance information is an integral part of the GPFFR and should be discussed in MD&A. Management's discussion and analysis should therefore address the most important facets of performance as well as the financial statements and supplementary information.

14. Regarding the financial statements, MD&A should answer questions such as the following, to the extent that they are relevant and important for the entity:

- What is the entity's financial position? What is its financial condition?[5] How did this come about?
- What were the significant variations:
  - from prior years?
  - from the budget?[6]
  - from performance plans, long-term plans, or other relevant plans in addition to the budget?
- What is the potential effect of these factors, of changed circumstances, and of expected future trends? In other words, to the extent that it is feasible to project the effects of these factors, will future financial position, condition, and results, as reflected in future financial statements, probably be different from this year's and, if yes, why? (Any such discussion should acknowledge that the future is unpredictable and will be

[5]The traditional concepts of "financial position" and "financial condition" are typically applicable to revolving funds, Government corporations, and other reporting entities that are intended to be self-financing. The concepts may be less relevant, or may require some qualification or modification, for other kinds of Federal reporting entities.

[6]Management should use its judgment to decide what variances are relevant for MD&A. It will not always be essential or appropriate to discuss all variances.

influenced by factors outside the reporting entity's control, including actions by Congress.)

15. Regarding systems and controls, MD&A should tell the reader whether internal accounting and administrative controls (some authorities prefer the term "management controls") are adequate to ensure that:

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards;
- assets are properly acquired and used, safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud; and
- performance measurement information is adequately supported.

16. Reporting information that helps people assess the condition of the entity's management systems and of the relevant internal controls is an important objective of Federal financial reporting. The relevant internal controls for this purpose are those that support reporting on financial and operating performance and reporting on compliance with applicable laws.[7] The great diversity of people (often with competing interests) affected by governmental action, and the fact that governments function within and by means of a framework of laws, mean that more attention to these matters is necessary than in financial reports for profit-seeking entities.

17. An entity's ability to prepare auditable financial statements and other reliable reports for management from the entity's books and records is a positive signal about the finance-related systems and controls of that entity. By themselves, however, the financial statements of a governmental entity do not provide adequate information about the status of the entity's management systems and internal controls that support reporting on financial and operating performance and reporting on compliance with applicable laws. For these reasons, the GPFFR of a Federal reporting entity should include information about systems, internal controls, and legal compliance, in addition to the basic financial statements. This information—like the information on performance—is presented in a discrete section of the GPFFR; alternatively it may be incorporated in the GPFFR by reference to separate reports such as those required by the Integrity Act. MD&A should therefore address the most important facets of this information on systems, controls and legal compliance, as well as the financial statements, supplementary information, and performance information.

[7]Internal controls are also relevant to other objectives. For example, controls help management assure efficient and effective use of resources for the purpose intended. They also support preparation of performance reports pursuant to GPRA. See, for example, paragraph 40.

Relationship to Other Reports

18. The information in the GPFFR about systems, internal controls, and legal compliance (column 6 in figure 1) may include the assertions and a summary of the reports on controls, legal compliance, and corrective actions pursuant to the Integrity Act and the Federal Financial Management Improvement Act (FFMIA), or those reports may be incorporated by reference. This information should be presented in conformance with guidelines published by OMB. MD&A, in turn, should discuss the most important aspects of the information on these topics. Referring to separately-issued reports on systems and controls does not eliminate the need to discuss these topics in MD&A.[8]

19. The performance information (column 4 in figure 1) may include the indicators in an entity's performance report pursuant to the Results Act or a selection of the most important performance indicators. Alternatively, a separate performance report may be incorporated by reference. This information should be presented in conformance with guidelines published by OMB. MD&A, in turn, will discuss the most important aspects of the performance information. Reference to a separately-issued performance report does not eliminate the need to discuss performance in MD&A.

20. The performance reports required by the Results Act may be voluminous for some agencies. In such cases, it may not be desirable to include all this information in the GPFFR. It is necessary to include at least some information about performance with the financial statements, however, so that people who use the GPFFR can understand why the costs reported in the financial statements were incurred and the consequences of doing so.

21. In the same way, the GPFFR by itself may not provide a comprehensive report on systems, controls and legal compliance. There may be voluminous reports from management and auditors on these topics. It is necessary to include at least some information about these topics, however, so that users of the GPFFR can understand whether the resources on which it reports were properly safeguarded and used for the purposes intended, whether reliable reports can be prepared, and whether the other objectives of internal controls are being met. This information is important both to provide a basis for understanding the financial statements themselves and to address the objectives of federal financial reporting.

22. Combining information on these topics adds value by putting the information about performance, internal controls, and systems in the context of audited financial statements. For example, the quality of information on the cost of outputs and outcomes of programs is

[8]Note that the purpose of the pilot Accountability Reports is to eliminate the need for numerous separate reports and to include the information required by those reports in a single report. For example, the Integrity Act requires an assertion on controls by the agency head. Pilot agencies are including this assertion in the Accountability Report.

enhanced by linking these indicators to the audited Statement of Net Cost. This is true even though the Statement of Net Cost may be too highly aggregated to identify separately all the programs reported on for the Results Act. Similarly, the auditor's tests of transactions and controls in connection with the audit of the financial statements provide information about the condition of the systems and controls used to safeguard resources and to assure that they are used for the intended purposes, in conformance with law. (Paragraphs 15 and 40-49 say more about the discussion and analysis of systems, controls, and performance.)

Authoritative Status of Accounting Concepts

23. This Statement of Federal Financial Accounting Concepts describes ideas and goals to guide the Board in its work. Concepts are not authoritative in the sense that they do not constitute accounting standards or principles for federal reporting entities. In particular, they are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the Codification of Statements on Auditing Standards published by the American Institute of Certified Public Accountants.

Topics For MD&A

24. This section provides specific suggestions for the content of MD&A. Like the other sections of this document, this material does not constitute accounting standards or principles for federal reporting entities. Except to the extent that OMB may issue supplementary mandatory guidance regarding the content of MD&A, the following items should be read as suggestions to be considered, not as prescriptive rules that must be followed.

Mission and Organizational Structure

25. MD&A should contain a brief description of the mission(s) of the entity and describe its related organizational structure.

Discussion and Analysis of the Financial Statements

26. Financial Results, Position and Condition[9]—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.[10] 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 funds from dedicated collections, 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).

27. Only those variations, balances and amounts, and stewardship matters of potential interest to readers who are not part of agency management should be discussed. Not all changes that are material to the GPFFR are sufficiently important to be included in MD&A. A line-by-line analysis of the financial statements is not generally appropriate. Instead, MD&A should summarize the most important items, explain the relevant causes and effects, and place them in context.

28. Budgetary Integrity—MD&A should concisely explain how budgetary resources have been obtained and used, instances in which their acquisition and use were not in accordance with legal authorization, the status of budgetary resources, and how information on the use of budgetary resources relates to information on the cost of program operations. MD&A should explain when major support for cost of a program or activity is provided outside the reporting entity's budget and when the entity's budget supports a program primarily reported by another entity. The discussion should describe major financing arrangements, guarantees, and lines of credit, including those not recognized in the basic financial statements.

29. MD&A should explain major changes during the period to the budget originally approved, major failures to comply with finance-related laws, and other matters management believes necessary. These could include:

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[9]For many readers program performance information is more important than the financial statements. The order in which topics are discussed in this document does not imply that performance information is of secondary importance. See paragraphs 43 and following.

[10]Materiality of effects to be discussed should be evaluated in the context of the specific reporting entity.

- unfunded liabilities that may require appropriations;
- assets that could be sold to augment future budgetary resources;
- amounts of payments that have not been matched with obligations;
- anticipated increases in the cost to complete long-term projects in progress that may require additional obligations or appropriations.

30. Use of Estimates—MD&A should concisely explain the use of estimates where that is important to understand issues discussed in MD&A, such as the major risks and uncertainties mentioned in paragraph 31 or the key forward-looking information discussed in paragraph 32. For example, the future expenses and the long term obligations[11] associated with major social insurance programs such as Social Security and Medicare should be discussed in MD&A of the financial report of the relevant reporting entities. These estimates are inherently imprecise and sensitive to several assumptions. Such factors would, therefore, be worthy of discussion in MD&A.

31. Current Demands, Risks, Uncertainties, Events, Conditions, and Trends—MD&A should describe important existing, currently-known demands, risks, uncertainties, events, conditions and trends--both favorable and unfavorable--that affect the amounts reported in the financial statements and supplementary information. The information called for by this paragraph and paragraph 32 is closely related. Preparers should combine the presentation of this information in whatever fashion is appropriate under the circumstances that apply to the reporting entity.

32. Future Effects of Current Demands, Risks, Uncertainties, Events, Conditions and Trends—The discussion of these current factors should go beyond a mere description of existing conditions, such as demographic characteristics, claims, deferred maintenance, commitments[12] undertaken, and major unfunded liabilities, to include a discussion of the possible future effect of those factors. (This discussion of possible future effect of existing, currently-known factors is required pursuant to the standards in *Standards for Management's Discussion and Analysis*.)

33. Future Effects of Anticipated Future Events, Conditions, and Trends—To the extent feasible and appropriate, the discussion should also encompass the possible future effects of anticipated future events, conditions, and trends, although this additional information is not required by the standards for MD&A.[13] For example, MD&A might discuss the possible future effect of anticipated trends in the cost of inputs that may significantly affect future

[11]The term "obligations" is used here in the customary sense, not as it is used in budgetary accounting.

[12]The term "commitments" is used here in the customary sense, not as it is used in budgetary accounting.

[13]Some projections that could involve consideration of anticipated factors would be presented as required supplementary stewardship information pursuant to the standards exposed for comment in FASAB's exposure draft Accounting for Social Insurance, February, 1998.

output costs. Other examples include the future effect of anticipated demographic trends, such as declining mortality rates, and the future effects of potential changes in behavior that may be caused by changes in Government programs. Such behavioral changes can greatly affect the future cost of some Governmental programs. For example, such effects can arise if subsidized insurance encourages the people or entities most at risk to participate in insurance programs ("adverse selection") or encourages risky behavior ("moral hazard").

34. An anticipated condition such as a prospective demographic trend or potential behavioral change may not, in itself, constitute a contingency or assumed risk that must be recognized, disclosed, or reported pursuant to SFFAS 5. Likewise, it may not be something that must be discussed in MD&A pursuant to the *Standards for Management's Discussion and Analysis*. Even so, if there is a reasonable prospect of a major effect on the reporting entity due to the anticipated condition, then MD&A should include this information to the extent feasible.

35. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts* or projections*. Such forecasts or projections can show the implications of existing policies and conditions in light of anticipated or reasonably possible future conditions. For example, for MD&A of the Government-wide financial statements, long-term projections of the deficit or surplus may be important indicators of financial condition and sustainability. For insurance programs, this kind of projection—which actuaries sometimes call "dynamic analysis"—would consider possible interactions among current assets, reserves, policies in force, expected future business or populations covered by the insurance, and potential behavioral changes such as adverse selection and moral hazard, if appropriate. Some programs are inter-related among themselves and/or with conditions in the private sector. For example, flood insurance programs and disaster assistance programs may be related to such an extent that analysis of programs individually would not provide a good idea of their potential impact on the Government. To the extent feasible, projections should consider the potential implications of such relationships.

36. The future implications of current or anticipated factors often can better be expressed as a range of possible outcomes and associated probabilities than as a single point estimate. Sometimes the implications may best be discussed in nonfinancial as well as financial terms. Forward-looking information can be highly useful, but management should avoid turning this part of MD&A into mere "lobbying" for more budgetary authority.

37. Understanding Financial Reporting—MD&A should make federal financial statements understandable to a wide audience, not just to users who are specialized analysts or members of the entity's management. There may be many potential sources of misunderstanding. Management should try to identify those sources of misunderstanding that may be important and deal with them in MD&A. Some of these are general and pervasive, such as those that may arise in the minds of new users of federal financial statements. New users may have been budget-oriented rather than accrual-accounting

oriented, or may be accustomed to seeing financial statements prepared on the basis of private sector accounting standards. A general discussion and reference to the Statement of Financing and the basis of accounting footnote may be sufficient for such users, although more specific treatment may be appropriate where the resulting differences in the reported amounts may be important to the understanding of users.

38. Emphasis that may be given in the financial statements to the costs of suborganizations and programs may require cautionary discussion of the relevance and utility of cost information. When MD&A itself discusses the cost of program outcomes, the problems of associating costs with outcomes may need to be discussed. In addition, the possible imprecision of cost information should be mentioned when it could be relevant to users' understanding. Similarly, any account-level discussion in MD&A of variations, balances, and amounts in the basic and stewardship information made in response to paragraphs 26 and 27 may require mention of the imprecision of amounts cited.

39. Exceptions and disclaimers in the auditor's report should be mentioned in MD&A, and management should respect the auditor's professional judgment if management expresses disagreement with auditor's findings. (This does not mean that management must refrain from stating views that differ from the auditor's; e.g., different views as to whether a weakness in control is material.) There may be other sources of misunderstanding. Management should be sensitive to them and guide the user to a better understanding when the problem could significantly affect the conclusions and judgments of substantial numbers of users.

Discussion and Analysis of Systems, Controls and Legal Compliance

40. The schematic diagram of a sample GPFFR on page 7 includes a discrete section that reports on the status of the entity's management systems and internal controls that support (1) preparation of financial statements and performance information in accordance with Federal Accounting Standards and management's criteria, respectively, and (2) the entity's compliance with applicable laws.[14] That section also describes material problems revealed

[14]These responsibilities are defined in numerous laws and administrative requirements, including the Federal Financial Management Improvement Act, OMB Circulars A-123 and A-127, and OMB Bulletin 98-08. A law of special importance in this connections is the Federal Managers' Financial Integrity Act of 1982 (FMFIA or the Integrity Act). The Integrity Act requires, in part, that "internal accounting and administrative controls of each executive agency shall be established.. and shall provide reasonable assurance that --
(i) obligations and costs are in compliance with applicable law;
(ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
(iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

by audits or otherwise known to management, and the corrective actions taken or planned regarding material problems.

41. Where relevant, management should discuss the results of audits of non-Federal entities such as those pursuant to the Single Audit Act as amended and OMB Circular A-133. MD&A should also discuss actions taken, in progress, or planned to address systemic problems in program design that contributed to the audit findings. Where relevant, management should describe the methods used to limit, detect, and recover improper payments; to assure that grantees and other nonfederal recipients of Federal funds use the funds as intended; and to assure that Federal and nonfederal entities comply with finance-related laws and regulations. MD&A should include a concise description of any major problems in these areas and of the corrective action taken or planned.

Discussion and Analysis of Performance

42. Performance Measurement—The objectives and needs of the Federal Government are markedly different from the objectives and needs of non-governmental organizations. This difference extends to the needs of those who use financial statements of governmental organizations. Their needs are different in many ways from the needs of investors, which the SEC's requirements address. In particular, reporting on the performance of governmental programs, organizations, and activities requires information that goes beyond the change in net assets and, indeed, beyond financial information.

43. The actual outcomes, accomplishments, or degree to which predetermined objectives are met provide indicators or measures of some aspects of effectiveness.[15] MD&A should objectively discuss the entity's program results and indicate the extent to which its programs are achieving their intended objectives.[16] Efficiency and effectiveness are important elements of performance measurement, and measuring cost is an integral part of assessing the efficiency and effectiveness of programs. Relating outputs (the quantity of services provided) to inputs (the cost incurred to provide the services) provides an indicator or measure of one aspect of efficiency. Information about effectiveness is often combined with cost information to help assess "cost effectiveness."

[15]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[*]," i.e., the difference between what actually occurred and what would have occurred in the absence of the program. Assessing impacts of Governmental action in this sense typically requires program evaluations or other techniques that transcend annual performance reporting, although these techniques often will avail of information i the annual performance reports. Valid and reliable evaluations of program impacts are not feasible for some programs. When they are conducted, they often require several years of data, are expensive, and typically are not performed on an annual basis for a given program.

[16]Paragraphs 106-111 and Appendix 1-F of Statements of Federal Financial Accounting Concepts 2, *Entity and Display*, discuss and illustrate reporting on performance in the GPFFR.

44. The entity's financial performance should be summarized to provide significant indicators of its financial operations for the reporting period. Indicators of financial performance are presented in notes and supplementary information as well as on the face of the principal financial statements, e.g., information about management of loans and accounts receivable. Financial performance is only one aspect of performance for governmental entities. Financial performance should be discussed to the extent relevant for the entity, in a way that appropriately balances the discussion of financial and nonfinancial performance relevant to the program or other reporting entity.

45. The discussion of performance should relate to major goals and objectives from the agency's strategic plan and to the indicators reported pursuant to the Results Act. It should explain what key performance indicators say about program performance. The summary discussion of performance in MD&A should:

- discuss the strategies and resources the agency uses to achieve its performance goals;
- provide a clear picture of actual and planned performance across the agency; and
- explain the procedures that management has designed and followed to provide reasonable assurance that the reported performance information is relevant and reliable.

46. The discussion of performance should:

- include both positive and negative results;
- present historical and future trends, if relevant (see paragraphs 31-36 regarding projections of the financial effects of known and anticipated demands, commitments, events, risks, uncertainties or trends for which a material financial effect is reasonably possible);
- be illustrated with charts and graphs, whenever helpful, for easy identification of trends;
- explain the significance of the trends;
- provide comparison of actual results to goals or benchmarks;
- explain variations from goals and plans; and
- provide other explanatory information that management believes readers will need to understand the significance of the indicators, the results, and any variations from goals or plans.

47. To further enhance the usefulness of the information, agencies should include an explanation of what needs to be done and what they plan to do to improve program performance.

48. Understanding Performance Reporting—Important limitations and difficulties associated with performance measurement and reporting should be noted to the extent relevant to the

vital performance indicators discussed in MD&A. The relevant limitations will vary from program to program, but some common factors that may need to be discussed include the following:

- performance usually cannot be fully described by a single indicator;
- indicators of performance do not, by themselves, say why performance is at the level reported; and
- focusing exclusively on quantifiable indicators can sometimes have unintended consequences.

49. For these and other reasons, performance indicators generally need to be accompanied by suitable explanatory information. Explanatory information helps report users understand reported indicators, assess the reporting entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance. Explanatory information may include, for example, information about factors substantially outside the entity's control, as well as information about factors over which the entity has significant control.

This Statement of Recommended Concepts 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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background and Project History

50. 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. FASAB published an initial exposure draft on MD&A in

January, 1997. The Board received comment letters on the initial exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Users, Academics and Others[17]		4	**4**
Auditors	7	3	**10**
Preparers and Financial Managers	16		**16**
Total	**23**	**7**	**30**

51. The basic rationale for MD&A has not changed since the initial exposure draft. As a result of its deliberations after receiving comments on the 1997 exposure draft, however, the Board made certain changes. The more significant changes are discussed below.

Concepts and Standards

52. The initial exposure draft was presented as a statement of recommended concepts. 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. The 1997 exposure draft asked respondents whether all or part of its 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 would be appropriate.

53. The Board concluded that, given the importance of MD&A as an integral part of the GPFFR, it would be appropriate to recommend standards for MD&A. At the same time, however, the Board concluded that for now this information should be treated as required supplementary information. The Board also agreed that no detailed requirements or guidelines for MD&A should be incorporated in federal accounting standards at this time beyond those proposed in the subsequent exposure draft (discussed below) titled *Standards for Management's Discussion and Analysis*. In other words, the Board agreed, a discussion and analysis that addresses the topics listed in the proposed standards should be an essential part of a complete GPFFR. At the same time, management should have great discretion about what

[17]This category include representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other GPFFR users.

to say regarding those topics, subject only to the criteria proposed in the exposure draft *Standards for Management's Discussion and Analysis* and the pervasive requirement that MD&A not be misleading. Because of this change, the Board decided to expose separately for further comment the proposed new standards and concepts. The exposure drafts were issued in October 1998; responses were requested by January 1999.

Responses to Second Exposure Draft

54. 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[18]	3	3	**6**
Preparers and Financial Managers	11		**11**
Total	**14**	**6**	**20**

55. 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.

Incorporation of Guidance in OMB Bulletin 97-01

56. This document, like both exposure drafts, integrates some of the guidance in OMB Bulletin 97-01 for preparing the "Overview" of the financial report with some of the guidance proposed in FASAB's initial exposure draft for MD&A. Some portions of the guidance regarding performance measurement in 97-01's discussion of the "Overview" have been omitted. As an interim step prior to implementation of the Results Act, OMB and many agencies used the Overview as a major vehicle for reporting on performance, not just as a summary and analysis. With the full implementation of the Results Act in FY 1999, however,

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

it will be appropriate to implement the financial reporting model contemplated in SFFAC 2. This contemplates a discrete section of the GPFFR focused on performance. Alternatively, performance information may be incorporated in the GPFFR by reference to another report or reports.

Management’s Assertions

57. Senior management of the reporting unit is responsible for the content of the GPFFR, including MD&A. Consistent with that, the initial exposure draft included the following paragraph:

> MD&A should include a discrete section with management’s explicit assertions that it is responsible for maintaining internal accounting and administrative controls that are adequate to ensure that
>
> - transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards;
> - assets are properly safeguarded to deter fraud, waste, and abuse; and
> - performance measurement information is adequately supported. [footnote omitted]

58. This paragraph, which was based on the language of objective four in SFFAC 1, was modified after the first exposure. The Board concluded that such assertions should be presented in a separate section of the GPFFR, not in MD&A. Alternatively, management’s assertions about internal control and related information about systems, controls, and compliance may be incorporated in the GPFFR by reference to another report or reports. (As noted previously, pilot agencies are including these assertions in their accountability reports.) FASAB expects to consider whether a new statement of standards is needed to assure that Federal financial reports adequately address objective four of Federal financial reporting, “Systems and Controls.” As noted in paragraph 41, MD&A should include a description of any major deficiencies in the management systems and internal controls designed to provide reasonable assurance that management responsibilities are satisfactorily carried out. It also should describe the corrective action planned.

Accountability Reports

59. The Board notes that the concept and practice of the “Accountability Report” continue to evolve through the pilot project voluntarily undertaken by several agencies. 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 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.

Incorporation by Reference

60. Some respondents were disturbed by the notion of providing program performance information through reference. Some were concerned that, if readers are merely directed to other reports for this information, the GPFFR will become irrelevant. They believe that the GPFFR should contain information about program performance, systems, and controls, not only in MD&A but also in discrete sections, such as the Statement of Program Performance discussed and illustrated in SFFAC 2, paragraphs 106-111 and Appendix 1-F.

61. The Board agrees that, as is stated in paragraph 20, “it is necessary to include at least some information about performance with the financial statements . . . so that people who use the GPFFR can understand why the costs reported in the financial statements were incurred and the consequences of doing so.”

62. The Board acknowledges that SFFAC 2 calls for and illustrates a Statement of Program Performance Measures. (Footnote 13 in SFFAC 2 explains that this statement is not “basic” information as that term is used in audit standards: “The Statement of program performance measures is not a basic financial statement. Nevertheless, it is an important component of the financial reports.”) The Board continues to believe that performance information is a vital, integral part of general purpose financial reporting. It should be noted, however, that SFFAC 1 and SFFAC 2 were issued before the performance planning and reporting requirements of GPRA became effective. The Results Act creates an elaborate new planning and reporting environment that is still evolving. Some details of the reporting model that were envisioned conceptually in SFFAC 2 may accordingly need to be revised slightly.

63. This statement of concepts is intended to be consistent with the previously stated goals and concepts of the Board, while recognizing that some details of how best to achieve those goals in the new context still need to be defined. OMB will play a key role in this process; FASAB may also provide further guidance in future projects. FASAB agrees that the GPFFR should not address performance, systems, and controls only by means of reference to other reports. The standards for MD&A require that MD&A do more than refer to other documents.

64. Others 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 be 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.

Appendix B: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary.”

Statement of Federal Financial Accounting Concepts 4: Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government

Status

Issued	January 27, 2003
Affects	None.
Affected by	None.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

In this Statement of Concepts, the Federal Accounting Standards Advisory Board (FASAB) has identified the intended or primary audience for the Consolidated Financial Report (CFR) of the US Government. FASAB also has described the characteristics of the audience and the qualitative characteristics FASAB believes will aid in meeting financial reporting objectives for the CFR. The concepts in this document are intended to help the Board as it develops accounting standards and the accounting and reporting framework for the Federal Government.

To provide guidance on the CFR, the Board reviewed its existing technical guidance on Federal financial reporting to discern how to apply that guidance to the CFR. It also researched other pertinent studies, and considered its experience with Federal accounting principles and the evolution of the CFR. The Board developed its assessment of who should be the general primary audience for the CFR. As a result of that review and assessment, the Board has identified five audiences for the CFR: Citizens, Citizen Intermediaries, Congress, Federal Executives, and Program Managers. However, the Board believes that the external user groups, Citizens and Citizen Intermediaries, are the primary audiences for the CFR.

The Board will rely on qualitative characteristics from SFFAC 1 in developing accounting standards for the CFR that will effectively meet the needs of the intended audience. These Qualitative Characteristics include: understandability, reliability, relevance, timeliness, consistency and comparability. While all these characteristics are important, given the intended audience for the CFR, understandability and timeliness are particularly fundamental to the usefulness of the CFR.

This concepts statement provides that the CFR should be a “general purpose” report directed to external users (citizens and their intermediaries), should address the Board’s objectives,[1] should have highly understandable information, and should be timely.

[1]Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Accounting Concepts* (SFFAC 1) defines those objectives in terms of user needs as 1) budgetary integrity, 2) operating performance, 3) stewardship, and 4) systems and control. See Appendix A for a description of these objectives.

Table of Contents

Introduction

1. **Relation of Federal Accounting Concepts and Standards to Governmentwide Consolidated Reporting.** The Federal Accounting Standards Advisory Board's (FASAB or "the Board") first Statement of Federal Financial Accounting Concepts, SFFAC 1, *Objectives of Federal Financial Reporting,* provides the foundation for generally accepted accounting principles, or GAAP, and for the Federal accounting and reporting framework. SFFAC 1 provides that Federal accounting and reporting should address four broad objectives: 1) budgetary integrity; 2) operating performance; 3) stewardship; and 4) systems and controls.[2] These objectives were developed based on studies of users' needs done during FASAB's initial years of operation and apply to all entity level reporting including agency, department, bureau or project level, and the Government as a whole. In addition to reporting objectives, SFFAC 1 established qualitative characteristics for information in financial reports (see pars. 156 to 164 of SFFAC 1).

2. Because of increased experience with, and interest in the US Government's primary consolidated financial report, the *Consolidated Financial Report of the US Government* (CFR), the Board has determined that concepts specifically directed to that report would be helpful. Such concepts would help guide the Board as it develops future standards and changes in its framework for financial accounting and reporting. This document provides concepts related to the primary audience for the CFR and identifies qualitative characteristics for the CFR. The Board may decide in the future to address other aspects of the CFR.

3. **Governmentwide Consolidated Reporting**. The preparer of the CFR, is the United States Department of the Treasury. Prior to any formal guidelines, Treasury voluntarily produced its first "prototype" governmentwide consolidated financial reports in 1976 for fiscal year 1975. The Government Management Reform Act of 1994 required the consolidated financial report of the US to be audited. Treasury's 1997 annual consolidated financial report was the first CFR to be issued pursuant to the Act and to undergo an audit. Since that time, Treasury has continued to refine the preparation and presentation of the CFR.

4. Currently, the CFR is an extensive, informative document that includes highlights of summarized agency level activity, consolidated financial statements, and some accompanying information whose source is not agency level entity reporting. The CFR includes both financial and non-financial information and has been focused on presenting understandable data for a variety of audiences. As a result, the report has grown in size and

[2]See Appendix A for a full description of these four objectives from SFFAC 1, *Objectives of Federal Financial Accounting Concepts.*

complexity. Some have questioned whether the CFR is trying to satisfy too many audiences with different needs in one format. Others believe that the information to be presented would depend on the needs of users and that identifying the primary users might better focus the CFR.

5. The Board determined that it would be beneficial to designate the intended or primary audience[3] and qualitative characteristics for the CFR that would be most useful for that audience.

Concepts: Intended Audience and Related Qualitative Characteristics for the CFR

6. The CFR should be a general purpose statement of accountability to the public. A general purpose report should be easily understandable to the "average citizen"[4] who has a reasonable understanding of Federal Government activities and is willing to study the information with reasonable diligence.[5] Moreover, the CFR 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.

7. The CFR should generally be directed to five user groups: Citizens, Citizen Intermediaries, Congress, Federal Executives, and Program Managers. However, citizens and citizen intermediaries should be the audience to whom the CFR is primarily directed.

8. The CFR should provide information that addresses the areas of the Board's objectives as identified in SFFAC 1: 1) budgetary integrity, 2) operating performance, 3) stewardship, and 4) systems and control. The Board does not intend that the CFR should satisfy all of the Board's objectives for all audiences. It earlier provided that each of the reporting objectives could be met to a greater or lesser degree by different statements prepared by different entities. For example, program and financing schedules for individual budget accounts

[3] The Board acknowledges that this concepts statement addresses only some aspects of CFR reporting. It may address further aspects as more experience is gained in CFR reporting.

[4] *Toward a Report to Citizens on the State of Their Nation and the Performance of Their Government: Proceedings of the AGA Task Force on a Report to Citizens on the State of the Nation,* November 1994, p.12 The report did not define "average citizen."

[5] Based on the definition of a general user as described in the Financial Accounting Standards Board Concepts Statement 1. The FASAB narrowed the definition to make it specific to the Federal Government.

could help address budgetary integrity, and financial statements from organizations could help address operating performance.[6]

9. SFFAC 1 also provides that information should be reliable, relevant, consistent, comparable, understandable and timely. While all of these characteristics are important for all reports and all users, it is particularly fundamental that the CFR be timely and understandable for citizens and citizen intermediaries. The content and structure of the CFR should be clear and complete to citizens and citizen intermediaries and the CFR should be available on a timely basis. For example, to be timely, the CFR should be issued not less than annually and as close to the end of the fiscal year as is possible.[7]

Basis for Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Intended Audience for the Consolidated Financial Report (CFR)

10. 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.

11. FASAB published the exposure draft, *Target Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, March 19, 2002. There were 12 respondents as described in the table below:

[6] Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, par. 56.

[7] The Board understands that the preparer's ability to meet this goal is beyond the Board's purview. Guidance on reporting deadlines is provided by the Office of Management and Budget.

Category	Federal (Civilian)	Federal (Military)	Non-federal
Users, academics, and others (includes professional organizations			5
Preparers and Financial Managers	6	1	
Totals	6	1	5

12. In general, respondents agreed with the Board's identification of the primary audience as citizens and citizen intermediaries. Other respondent comments are addressed in the discussions that follow.

13. In providing guidance on the CFR, the Board primarily relied on its earlier conclusions supporting decisions on SFFAC 1, *Objectives of Federal Financial Information*. It then filtered into those conclusions its years of experience subsequent to its earlier conceptual work and other pertinent literature that describes user groups of government-level financial information. In particular, the Board relied on one of the most extensive studies on user needs for Federal Government financial information, the joint US-Canadian user needs study, Federal Government Reporting Study of March 1986. In this study, conducted by the US Comptroller General and the Auditor General of Canada, the researchers identified similar groups of users as those the Board had identified in SFFAC 1 and in this document.

14. The Board agreed that, in general, users of Federal financial information fall into the four categories identified in SFFAC 1: Citizens, Congress, Executives, and Program Managers.[8] However, for information at the more highly summarized governmentwide or consolidated level the Board divided those four groups identified in SFFAC 1 into two major groups: external users (Citizens), and internal users (Congress, Executives, and Program Managers).

15. The Board believes that citizens should be the primary audience for the CFR. This is based on the notion that citizens as compared to the other groups do not have ready access to more detailed Federal financial reports on which to make decisions. Moreover, they may not have the knowledge or desire to take the time to understand more sophisticated reports, preferring instead to look to a more summarized report for highlights of interest. Thus, the Board believes that the CFR should not attempt to meet all users needs for all objectives. Instead it should focus on meeting the basic needs of citizens for highly summarized information.

[8] SFFAC 1, par. 88-104.

16. Further, for the CFR the Board believes that the Citizen user group identified in SFFAC 1 has two different sets of needs and therefore should be divided into two groups: Citizens and Citizen Intermediaries. Citizen needs are more specifically targeted to issues of general interest and to broad indicators of the overall financial health of the Government. On the other hand, Citizen Intermediaries devote more time to reading, analyzing, and interpreting more detailed information that they then analyze, summarize, and pass on to Citizens for further application. For these reasons, the Board expanded its original four groups of users to five user groups for the CFR. The group characteristics are summarized in the paragraphs that follow.

External Users

17. *Citizens*. This group includes individuals outside the Government who are interested in information that supports their goals of generating and preserving income and savings, and improving their standard of living.[9] Citizens are interested in many aspects of the Federal Government. They are concerned about individual programs, candidates for office, the services the Government provides, and the fiscal responsibility of their elected and appointed representatives. Citizens receive and pay for Government services and therefore are concerned with the outputs and outcomes of those services and the efficiency with which they are provided. Citizens are concerned about their families and, in particular, with the financial burden their children and grandchildren will inherit.[10] These users are interested in a "comprehensive but concise…report [that would provide] a broad and complete picture of the Government's…many and varied activities and resulting overall financial position."[11]

18. Citizen Intermediaries. This group also includes individuals from outside the Government. It includes, among others, individuals such as: the media; public interest and advocacy groups; state and local legislators and executives; and analysts from corporations, academe and elsewhere. As citizens typically have limited time and ability to analyze reports about their government, they want and rely on assurances that the government is functioning economically, efficiently, and effectively.[12] However, citizens, for the most part, "would look to analysts in the media, financial institutions, policy institutes, etc., to do such analysis for them."[13] Citizen intermediaries would analyze and interpret the more detailed information to

[9] *Federal Government Reporting Study: A Joint Study by the Office of the Auditor General of Canada and the US Government Accountability Office*, March 1986, p.10.

[10] SFFAC 1, par. 77.

[11] *Federal Government Reporting Study,* p.v.

[12] SFFAC 1, paragraph 77.

[13] Ibid. p.5.

deliver it to citizens. They also would provide more in-depth analysis that citizens may not have the desire or the ability to perform. Citizen intermediaries typically have more skill, time and ability to gather and analyze detailed data from alternative sources.

19. Intermediaries are interested in all of the major facets of each of the Board's objectives, including individual programs; Government services and activities; fiscal responsibility of elected and appointed representatives; program outputs and outcomes; and assurances of Government economy, efficiency and effectiveness. Intermediaries, therefore, are interested in a wider array of information on all aspects of budget, program operations, the Federal Government's stewardship, and systems and controls. "Media and analysts are the most frequent direct users of Federal Government financial reports, the major source of information about the Government for citizens and corporations, and an important source of information for legislators."[14] The Board believes that intermediaries may rely on the CFR as a starting point but that they will seek more detailed reports.

20. The Board agrees with the conclusion of the Federal Government Reporting Study. A significant finding was that "users depend on each other for the communication of financial information about the Federal Government. Legislators - generally considered to have a primary role in the use of Federal Government financial information - depend to a considerable extent on the interpretations of information by analysts and the media to provide them with the understanding they need. This also applies to citizens and corporations. Thus, needs of analysts and the media are considered crucial because, if they are not well served, the understanding of government activities by others will suffer."[15]

Internal Users

21. Internal users are those groups inside the Federal Government who typically have more access to the myriad of Federal Government information including summarized and detailed financial, program, budget, cost, and economic reports and analyses for all entities. Because they are able to get information on their specific issues of interest, they might benefit from the CFR but are not its primary audience. Internal users include Congress, Federal executives, and program managers. Of these three internal users, some have considered Congress as the ultimate intermediary between the public and its Government. That notwithstanding, Congress, as would the other internal users, has access to more specific internal information and reports for conducting its work. Thus they are not the main audience of the CFR. However, these users may rely on the CFR with its broad indicators and summarized information as "a reference document to lead to more detailed or

[14] Ibid. pp.5-6.

[15] Ibid. pp. iv-v.

disaggregated information in specific areas."[16] Each internal user has access to detailed, disaggregated information, but relies on summarized data in a more limited capacity as indicators for general Governmental financial position and condition. Internal users would use the CFR to provide "an overall picture of the financial health of the Government that is not available elsewhere…[and provide it with] a general framework to situate [its] own activities."[17]

Summary

22. Based on the above analysis, the Board concluded that the CFR would be of general interest to five user groups. However, the Board believes that the external user groups representing the general public, that is, Citizens and Citizen Intermediaries, are the primary audiences for the CFR.

23. The Board also considered comments from respondents to its exposure draft (see paragraph 11). Some respondents requested that specific individuals be added to the examples of persons included in the Citizen Intermediary group. Since the Board intended that the individuals listed in the group description were typical examples rather than an exhaustive list, it decided not to expand the list of examples. Rather it decided to slightly modify the wording of the description of the Citizen Intermediary group to clarify that the individuals and groups listed are typical examples and not an exhaustive list.

Qualitative Characteristics

24. To be useful, FASAB's SFFAC 1 provides that information should be reliable, relevant, consistent, comparable, understandable and timely. The FASAB considers these characteristics as it deliberates standards applicable to all Federal reporting entities, both agency level and the government as a whole. In the Federal environment, satisfaction of these characteristics occurs when FASAB develops standards for Federal reporting. At the CFR level, where the audited agency level data are aggregated, the manner in which the data are presented to the general audience for which the CFR is intended is a fundamental consideration. Because Federal financial statements differ from commercial financial statements in concept, form, volume, and complexity and the intended audience for Federal financial statements is so all encompassing, the FASAB is emphasizing the need for the CFR to be understandable. The Board concurs with a study by the Association of Government Accountants on Government accountability reporting that concluded that, "the problem of reporting to the citizens is not primarily one of inability to develop meaningful

[16] Ibid. p.8.

[17] Ibid. p.9.

information or lack of it. Rather, the principal problem is the manner in which this information is communicated to the American citizens."[18] The study suggested that the abundance of detailed financial data published by the Government does not give citizens a succinct and comprehensive picture of the Government's activities.

25. To support supplying citizens with a full picture of Government activities in an understandable manner, the Board concluded that each user group should be able to easily locate the types of information in which it might be interested. For example, if an item is reported, all information related to that item should be reported in one primary location, if feasible.[19] If not feasible, the report should provide clear linking language, notes, or other information that would guide the reader to the information on the item or topic that is split among different sections of the report. Ultimately, the CFR's content and structure should be clear and complete to users.

26. In addition to the characteristic of understandability to citizens who may not have detailed knowledge of accounting principles (discussed above), this concepts statement emphasizes the qualitative characteristic of timeliness as being important for the CFR. As noted in SFFAC 1 (par. 162), "if financial reports are to be useful, they must be issued soon enough to affect decisions." No matter how relevant, reliable, consistent, or comparable information might be, if the intended audience does not understand the information or if the information is not available in a timely manner, the information will not be useful to or used by that audience.

27. The Board also considered comments from some respondents who did not believe that the qualitative characteristics of understandability and timeliness should be emphasized at the expense of the other 4 characteristics (relevance, reliability, consistence and comparability). The Board affirmed that its intent as stated in paragraph 9 of the exposure draft was to acknowledge that all 6 characteristics were important for all reports and users. Its focus on the characteristics of understandability and timeliness related to the aggregated nature of the report and the intended audiences. It decided to delete the last two sentences of paragraph 22 of the exposure draft:

> Thus, these two qualitative characteristics (understandability and timeliness) serve as a foundation for constructing accounting standards for a useful CFR. The Board will consider the other qualitative characteristics as standards are developed, considered, and adopted.

[18] *Toward a Report to Citizens on the State of Their Nation and the Performance of Their Government: Proceedings of the AGA Task Force on a Report to Citizens on the State of the Nation,* November 1994, p.25.

[19] If items to be reported have mixed levels of audit coverage, the level of audit coverage for each item should be clearly identified. The audit standards in AU 558 will govern the labeling of the items.

28. The Board believes that these two sentences caused some respondents to conclude the other 4 characteristics were not important to the Board.

General Purpose Financial Reporting

29. Since the Board considers the CFR a general purpose financial report, it reiterates its discussion from SFFAC 1, where it described the limitations of financial reporting. It said that "general purpose financial reporting is not the only source of financial information … In many cases, users of general purpose financial reports need to consult other sources to satisfy their information needs…While certain information is provided by general purpose financial reports, other information is better provided by, or can be provided only by, financial reporting outside such reports. Still other information is provided by nonfinancial reports or by financial reports about segments of the national society other than the Federal Government and its component entities (e.g., economic reporting)." [20]

Board Approval

30. The Board unanimously approved issuing this concepts statement.

[20] SFFAC 1, *Objectives of Federal Financial Reporting*, par. 30-31.

Appendix A: Objectives of Federal Financial Reporting[21]

31. **Budgetary Integrity**. 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. Federal financial reporting should provide information that helps the reader to determine

    - how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
    - the status of budgetary resources, and
    - how information on the use of budgetary resources relates to information on the cost of programs [and] operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

32. **Operating Performance**. 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. Federal financial reporting should provide information that helps the reader to determine

    - the costs of providing specific programs and activities and the compositions of, and changes in, these costs;
    - the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs; and
    - the efficiency and effectiveness of the Government's management of its assets and liabilities.

33. **Stewardship**. 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 conditions have changed and may change in the future.

34. Federal financial reporting should provide information that helps the reader to determine whether

    - the Government's financial position improved or deteriorated over the period,

[21] From Statement of Federal Financial Accounting Concepts 1, SFFAC 1, *Objectives of Federal Financial Reporting*, par. 13-17.

- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- Government operations have contributed to the Nation’s current and future well-being.

35. **Systems and Controls**. Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purpose authorized, and are recorded in accordance with Federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse, and
- performance measurement information is adequately supported.

Appendix B: Acronyms

AICPA – American Institute of Certified Public Accountants

CFR – Consolidated Financial Statement of the US Government

FASAB – Federal Accounting Standards Advisory Board

GAAP – generally accepted accounting principles

SFFAC – Statement of Federal Financial Accounting Concepts

SFFAS – Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Concepts 5: Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements

Status

Issued	December 26, 2007
Affects	None.
Affected by	None.

See pages 6-7 for the preamble to Statement of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

Objective of this Statement

Elements of financial statements result from an entity's transactions or other events that affect the entity. Elements are the “building blocks” of financial statements-the broad classes of items from which the statements are constructed. This Statement defines five elements of accrual-basis financial statements of the federal government. Items that meet the definitions also are elements of accrual-basis financial statements of the relevant component entity. The elements are defined as follows:

An ***asset*** is a resource that embodies economic benefits or services that the federal government controls.

A ***liability*** is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

A ***revenue*** is an inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

An ***expense*** is an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

This Statement establishes two basic recognition criteria that an item must meet to be a candidate for recognition in the body of a financial statement: (1) the item must meet the definition of an element and (2) the item must be measurable, meaning a monetary amount can be determined with reasonable certainty or is reasonably estimable. An item that meets the definition of an element but is not measurable is a candidate for disclosure in the notes to financial statements or as supplementary information.

Meeting the basic recognition criteria is a necessary but not a sufficient condition for recognition. Additional considerations for a recognition decision are measurement of the candidate for recognition and assessments of the materiality and benefit versus cost of the amount measured. Measurement entails selection of an appropriate attribute, such as historical cost, fair value, or expected value, and application of a measurement method. Measurement may require the use of estimates or approximations and, for items that meet the definition of an asset or a liability, an assessment of the probability that future inflows or outflows of economic benefits or services will result from the item.

This Statement includes a discussion of the effects of uncertainty on financial reporting but does not otherwise address the assessment of probabilities or other measurement issues. The Board intends to address those considerations for recognition decisions in future pronouncements. In the meantime, this Statement does not change existing standards for assessing probabilities or for selecting the appropriate measurement attribute, which the Board expects will continue to be based on the reporting objectives, qualitative characteristics, and cost-benefit constraints applicable to financial information.

Reasons for this Statement

Questions have arisen about the usefulness of certain definitions of elements in current standards and their applicability to transactions outside the scope of the defining standard, as well as about the absence of definitions of other important elements, such as assets. The Board believes that a concepts statement that defines the elements of federal accrual-basis financial statements and establishes basic criteria for selecting candidates for recognition will be an important part of its conceptual framework. The Board believes that this Statement will provide more consistent, useful, and enduring guidance to the Board and its constituents than establishing definitions and recognition requirements standard by standard.

The concepts, definitions, and basic recognition criteria in this Statement will provide a common foundation for distinguishing between items that meet the definitions of elements of accrual-basis financial statements and those that do not, and between items that are candidates for recognition in the body of financial statements and those that qualify only for disclosure in the notes or as supplementary information. The Board therefore believes that the guidance in this Statement will enhance the understandability, consistency, and comparability of financial reporting for the benefit of users, preparers, and auditors of the financial statements as well as the Board itself. As a result, the Board believes that this Statement will contribute to meeting the government's overall financial reporting objectives of demonstrating accountability and providing useful information, as well as the more specific objectives of assisting users in evaluating a reporting entity's operating performance and stewardship.

Effect on Practice

The concepts in this Statement are consistent with those established in earlier SFFACs,[1] which are not superseded or modified by this Statement. The definitions of elements and basic recognition criteria in this Statement also are generally consistent with current practice and do not imply radical change. However, they are expected to guide the Board's future deliberations.

[1] SFFAC 1, *Objectives of Federal Financial Reporting*; SFFAC 2, *Entity and Display*; SFFAC 3, *Management's Discussion and Analysis*; and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*.

Table of Contents

Acronyms

AcSEC	Accounting Standards Executive Committee of the AICPA
AICPA	American Institute of Certified Public Accountants
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	General Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Introduction

Purpose Of This Statement

1. This Statement of Federal Financial Accounting Concepts (SFFAC) establishes definitions and **basic recognition criteria**[2] for **elements** of accrual-basis financial statements of the federal government and its component entities. The concepts it contains are consistent with the concepts established in earlier SFFACs,[3] which are not superseded or modified by this Statement. The definitions of elements and basic recognition criteria in this Statement also are generally consistent with current practice and therefore do not imply a fundamental change. However, they are expected to guide the Board's future deliberations.

Elements and Recognition

2. The term *elements* refers to broad classes of items, such as **assets** and **liabilities**, that comprise the building blocks of financial statements. Components of those broad classes, such as cash, investments, and debt instruments, may meet the definitions of elements but are not elements as the term is used in this Statement. Instead, they are called *items* or by descriptive names. This Statement focuses on the broad classes and their characteristics instead of defining particular assets, liabilities, or other items. Notes to financial statements generally are considered an integral part of financial statements, but they are not elements. They serve different functions, including amplifying or complementing information about items reported in the body of financial statements.

3. The elements of accrual-basis financial statements defined in this Statement (paragraphs 18 through 56) are assets, liabilities, **net position**, **revenues**, and **expenses**. The definitions of assets and liabilities derive from the essential characteristics of those elements. The definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities.

4. The terms ***recognition*** and *recognize* refer to the process of formally recording or incorporating an element into the financial statements of an entity. Recognition comprises

[2] Terms defined in the Glossary are printed in **bold-face** type the first time they appear in the text.

[3] SFFAC 1, *Objectives of Federal Financial Reporting*; SFFAC 2, *Entity and Display*; SFFAC 3, *Management's Discussion and Analysis*; and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government.*

depiction of an element in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements.

Concepts

Recognition

Basic Recognition Criteria

5. Basic recognition criteria are the conditions an item should meet in order to be a candidate for recognition in the financial statements. The basic recognition criteria established in this Statement are (a) the item meets the definition of an element of financial statements and (b) the item is **measurable**. As used in this Statement, the term *measurable* means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.

6. The existence or measurability (or both) of many assets, liabilities, and other elements may not be certain, but this Statement does not require certainty. Uncertainty and its effects on financial reporting are discussed in paragraphs 57 through 59. Conclusions about whether an element exists and is measurable may require judgment based on the available evidence.

Additional Considerations for Recognition Decisions

7. Meeting both of the basic recognition criteria established in paragraph 5 is a necessary but not a sufficient condition for recognition. Additional steps are necessary before a recognition decision can be made. For example, a candidate for recognition needs to be measured. **Measurement** of an item entails the selection of an appropriate attribute to be measured, such as historical cost, fair value, or expected value, and application of a measurement method. Measurement may require the use of estimates and approximations as well as an assessment, in a manner consistent with the attribute being measured, of the probability that future inflows or outflows of economic benefits or services will result from the item. Recognition decisions also incorporate the results of assessments of the materiality and benefit versus cost of recognizing the item measured. Thus, it is possible that an item that meets the basic recognition criteria would not be recognized due to measurement, materiality, or cost-benefit considerations.

8. This Statement establishes the basic recognition criteria for elements but does not address these additional considerations for recognition decisions. The Board intends to establish concepts and standards for these additional considerations in future pronouncements. In the meantime, this Statement does not change existing standards for measurement or for assessing probabilities. The Board expects that the selection of an appropriate measurement attribute in specific circumstances will continue to be based on the reporting objectives, **qualitative characteristics**, and cost–benefit constraints applicable to financial information.

9. An item that meets the appropriate definition of an element is an asset, liability, revenue, or expense, even if it is not recognized in the accrual-basis financial statements because, for example, it is not measurable or its amount is not material. Unrecognized elements are candidates for disclosure in the notes to financial statements or as supplementary information.

Entity Concept

10. All elements defined in this Statement are defined in relation to the U.S. Government ("federal government" or "government"). That is, an item that meets the relevant definition is an asset, liability, net position, revenue, or expense of the federal government. An item that meets the basic recognition criteria established in paragraph 5 and the additional considerations for recognition decisions referred to in paragraph 7 is recognized in the consolidated financial statements of the federal government, except when it is eliminated in the consolidation process, as discussed in paragraphs 14 and 15.

11. The federal government is composed of component entities that **control**, manage, or are otherwise accountable for the government's assets and may be authorized to incur liabilities. Component entities include departments, independent agencies, and government corporations, as well as their agencies, bureaus, offices, administrations, corporations, and other organizational units. An item that meets the definition of an element of the federal government is also an element of a component entity. It is recognized in the component entity's accrual-basis financial statements provided it meets the basic recognition criteria and the additional considerations for recognition decisions.

12. Sometimes a question may arise as to which component entity should report a particular item. Typically, a review of the authorizing legislation establishing a government program or activity, the appropriations act funding it, and related federal laws, regulations or other executive issuances clearly identifies one component entity as having a comprehensive relationship to the program or activity. That is, the component entity is responsible and accountable for receiving, controlling, managing, and utilizing government assets or incurring liabilities on behalf of the government in performing operations related to the

program or activity. When a component entity has such a comprehensive relationship, the assets and other elements involved should be reported by that component entity.

13. When no component entity has a comprehensive relationship to a government program or activity, the assets and other elements involved should be reported by the component entity most responsible for managing them. For example, assume that two component entities support a single program to which neither has a comprehensive relationship. If one of the component entities has acquired and has some control over a government asset but the other component entity presently manages and utilizes the asset as part of its routine operations, the second component entity should report the asset. In other circumstances, a component entity's management responsibilities may be limited to, for example, collecting monies owed to the federal government and depositing them in the U.S. Treasury. Although the component entity has no authority or responsibility to retain or use the monies collected, it should report the assets and other elements involved in the collection activity.

14. While items that meet the definition of an element from the perspective of the federal government are assigned to component entities, some items recognized in the accrual-basis financial statements of component entities are not recognized in the consolidated financial statements of the federal government because they do not meet definitions of elements from the perspective of the federal government. Instead, they are items that would meet element definitions from the component entity perspective and are treated as such by the component entity. For example, component entities may exchange services for a fee and recognize the resulting intra-governmental assets, liabilities, and related elements in their financial statements. However, intra-governmental items offset each other when the government is viewed as a whole and are eliminated in preparing the government's consolidated financial statements.

15. Appropriations are another example of items reported in the accrual-basis financial statements of component entities but not in the consolidated financial statements of the federal government. For the component entities, appropriations are inflows of **resources** against which the component entity may incur obligations in support of authorized activities. Assuming an appropriation complies with the basic recognition criteria and additional considerations for recognition decisions, a component entity would recognize the appropriation as an increase in assets and revenues and would recognize the use of the appropriation as an increase in expenses and a decrease in fund balance with Treasury. However, from the perspective of the government as a whole, an appropriation is not a resource flow to the federal government or from the government to a component entity. Rather, it is a budgetary amount that constitutes legal authority for a component entity to incur obligations for specified purposes during specified time periods, and for the U.S. Treasury to liquidate the resulting obligations of the component entity. The actual liquidation will be from cash and other assets of the U.S. Treasury resulting from the inflow of resources from taxes and other financing sources. Therefore, appropriations recognized by

component entities are eliminated in the process of consolidation and are not reported in the consolidated financial statements of the federal government.

16. The definitions of elements may refer to *another entity* or *other entities*. For the federal government, these terms describe entities external to the government, such as foreign, state, and local governments, business enterprises, not-for-profit organizations, and individuals. For a component entity, the terms *another entity* and *other entities* include other component entities of the government as well as entities external to the government.

Definitions Of Elements

Applicability of Current Conditions, Including Current Law

17. Assessments of whether an item meets the definition of an asset, liability, revenue, or expense are based on conditions that exist at the reporting date, including current law, because all elements of accrual-basis financial statements are based on transactions or events that already have occurred. Therefore, if an item meets (or does not meet) the definition of an element under the conditions in effect at the reporting date, the power of the government to subsequently change those conditions does not eliminate (or create) an element at the reporting date. For example, if an item meets the definition of a liability at the reporting date, the power of the government to subsequently change the law so that the item no longer meets the definition does not eliminate the existence of the liability at the reporting date.

Assets

Definition of an Asset

18. An asset is a resource that embodies economic benefits or services that the federal government controls.

19. The definition of an asset addresses only whether an asset exists. It does not address whether the asset is measurable and, if so, how it should be measured or whether or when it should be recognized in the federal government's or a component entity's balance sheet. Nor does the definition address whether or when the economic benefits or services embodied in an asset will be used. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other considerations for recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an

element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

20. The definition of an asset derives from the nature of assets—that is, their **essential characteristics**. An essential characteristic of an asset is one that is inherent to all assets and, therefore, without it an asset would not exist. Paragraphs 21 through 35 highlight and discuss those characteristics. Also discussed are certain characteristics that are common to many assets but not to all assets. As such, those characteristics are not essential, but they may provide additional evidence that an asset exists.

Essential Characteristics of Assets

21. The federal government needs financial, economic, human, and other resources to help it achieve its mission. In this context, the term *resource* means "a useful or valuable possession or quality of a country, organization or person"[4] or a "means of supplying a want."[5] The government has numerous resources. However, those resources are not assets unless they have the essential characteristics of assets and, therefore, meet the definition of assets in paragraph 18.

22. To be an asset of the federal government, a resource must possess two characteristics. First, it embodies economic benefits or services that can be used in the future. Second, the government controls access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.

23. To illustrate the distinction between a resource that is an asset and one that is not, the federal government may obtain economic benefits or services from a resource but be unable to deny or regulate the access of other entities to those benefits or services. If so, the resource is not an asset of the federal government. For example, outer space is a natural resource from which the federal government can obtain economic benefits. However, outer space is not an asset of the federal government because the government cannot deny or regulate the access of others. In contrast, natural resources under federal lands qualify as federal government assets because the government can obtain the economic benefits and regulate the access of other entities as provided under federal law. Such natural resources are assets of the federal government even if they are not measurable and therefore are not candidates for recognition in the financial statements.

[4] *American Heritage Dictionary of the English Language*, Fourth Edition (Houghton Mifflin Company, 2000)

[5] *The Concise Oxford Dictionary* Oxford, U.K.: Oxford University Press, 1964.

24. In addition to the two essential characteristics identified in paragraph 22, many resources have other features that help identify them as assets. For example, they may be acquired at a cost and owned by the federal government. However, those features are not characteristics of all assets. Whereas access to economic benefits or services often is obtained through legal ownership of the underlying item of property, legal rights to economic benefits or services can be obtained without ownership of the property—for example, under certain lease arrangements.

25. The federal government's resources often are tangible and exchangeable, and the government often has legally enforceable rights of access to the resulting benefits. But the absence of those features is not sufficient to preclude an item from qualifying as an asset. For example, an intangible resource, such as an easement on property, is an asset if the federal government can benefit from it and regulate or deny the access of other entities. A resource may embody economic benefits even though the federal government cannot exchange it or sell it—for example a machine that continues to provide a needed service even though there is no market for the machine. Similarly, the fact that the government's ability to access or use a resource is not legally enforceable does not mean that the resource is not an asset, if the government nevertheless can obtain the economic benefits or services it embodies and deny or regulate other entities' access to or use of those economic benefits or services.

Economic Benefits or Services

26. A characteristic possessed by all assets is the ability to provide economic benefits or services. Some sources use the terms *economic benefits* and *services* (or *service potential*) interchangeably. However, as used in this Statement, economic benefits may result in inflows of cash, cash equivalents, goods, or services to the federal government, whereas the services embodied in an asset may benefit the government in other ways. For example, assets such as public parks, museums, and art galleries often provide recreational, educational, and research opportunities to the public at no charge or for a reduced fee or voluntary contribution, thereby assisting the federal government to achieve its objectives and meet its mission to provide public services.

27. The economic benefits or services that a property can provide can be distinguished from the property itself, whether it is tangible or intangible, such as a right. Not all properties embody economic benefits or services and the assumption that a particular type of property will always be an asset is not justified. For example, whereas equipment normally is expected to provide economic benefits or services, sometimes it has become unusable and has no scrap value. If so, it no longer embodies economic benefits or services and does not meet the definition of an asset.

28. The economic benefits or services embodied in resources may be shared by the government and another entity through specific arrangements. For example, the government and another entity may enter into a joint venture and share an interest in the resources committed to the joint venture. If so, each party may possess assets comprising its respective share of the benefits or services. Similarly, lease agreements unbundle the economic benefits or services embodied in leased property and may, for example, give the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value. Thus, both parties may have assets corresponding to their respective rights.

Control by the Federal Government

29. The second essential characteristic of an asset is control, which refers to the *ability* of the federal government to obtain the economic benefits or services embodied in a resource and to deny or regulate the access of others. It is possible that the government does not actively *exercise* control. Nevertheless, as long as the government currently has the ability to exercise control, the item is an asset of the government. In exercising control of the economic benefits or services, the government may, depending on the nature of the resource, hold the resource; exchange it; use it to obtain cash, cash equivalents, goods, or services; exact a price for other entities' use of the economic benefits or services; or use it to settle liabilities. Many resources are subject to certain legal or other external constraints, such as public land subject to preservation requirements. Such restrictions on the use of a resource do not negate the government's control of the economic benefits or services embodied in the resource.

30. The ability of the federal government to control access to the economic benefits or services embodied in a resource normally stems from legal rights and may be evidenced by title deeds, contractual agreements, possession, or other devices that protect the government's interests. However, legal enforceability of a right is not a prerequisite to the establishment of control of access to economic benefits or services, because the government may be able to exercise control in some other way.

31. Possession or ownership of a resource normally entails control of access to the economic benefits or services embodied in it, but that is not always the case. Whereas control of access is an essential characteristic of an asset, possession or ownership is not. For example, the government may grant another entity, acting as an agent of the government, physical possession of goods for sale and retain the right to receive the proceeds of sale. The goods are assets of the government because it controls access to the economic benefits embodied in the goods. The agent has physical possession of the goods, but they are not the agent's assets because it does not control access to the economic benefits. Also, as discussed in paragraph 27, through a lease arrangement the government may

control access to the economic benefits or services embodied in a resource that it does not own.

32. Sometimes the federal government cannot control the economic benefits or services that it obtains from a resource because it cannot deny or regulate the access of other entities. In those circumstances, the resource does not meet the definition of an asset of the federal government. Public goods are an example. Public highways provide economic benefits to the entities that use them. However, they are assets only of the entity that has the capacity to control their use or regulate other entities' access to them by, for example, the use of tolls or other restrictions. Similarly, natural resources, such as air and water do not qualify as assets of the federal government when it has only general access to them along with all other entities, even if the government has incurred costs to help clean the environment.

33. The federal government obtains most of its resources from cash or credit transactions. The government may acquire resources in exchange for other resources or for an obligation to transfer resources or provide services in the future, or resources may result from the exercise of the government's powers, such as, for example, the imposition of taxes, penalties, fines, and forfeitures. Government resources also may result from events such as accretion and discovery.

34. Implicit in the definition and essential characteristics of assets is that the event giving rise to the government's ability to control access to the economic benefits or services embodied in a resource must have occurred. The government's intent or ability to acquire a resource in the future does not create an asset. For the resource to qualify as an asset, the government already must have acquired the resource or otherwise obtained access to the economic benefits or services it embodies to the exclusion of other entities. For example, the mere existence of the government's power to tax is not an asset because, until the government has exercised that power by imposing a tax and has access to benefits by virtue of completion of a taxable event, no event has occurred to generate resources and there are no resulting economic benefits that the government can control and use in providing programs and services.

35. Once acquired, a resource that meets the definition of an asset continues to be an asset until the government transfers it to another entity or uses it up, or until some other event or circumstance destroys the economic benefits or services previously embodied in the resource or removes the government's ability to obtain them and deny or regulate the access of other entities.

Liabilities

Legal Framework

36. The federal government is governed by and operates within a framework of laws. Thus, a federal liability must have its foundation in law. Some federal liabilities result from discrete actions of the government that are authorized by law but are not explicitly required by law. Examples are liabilities that result from contractual arrangements, including amounts borrowed, amounts owed for purchased goods and services, and liabilities for providing goods or services to entities that have paid for them in advance. Other liabilities flow directly from a law and its implementing regulation that specifically require the federal government to provide assets to another entity. Examples include formula grants and subsidies, claims owed under workers' compensation, and amounts owed for environmental clean-up.

37. Although all federal liabilities have their foundation in law, some liabilities are construed from the totality of the conditions and facts of a particular situation, rather than from specific legal or regulatory requirements. In those circumstances, the government should weigh the totality of the facts of the situation against the definition and essential characteristics of liabilities (discussed in paragraphs 41 through 48) and make an informed judgment as to whether or when a liability has been incurred. Factors that may affect that conclusion include relevant aspects of the legal framework within which the government is constituted, whether the government has an agreement or understanding with another entity concerning the nature and amount of the government's obligation and the timing of settlement, and decisions or actions in previous situations that are relevant precedents.

38. Settlement of a federal liability often is legally enforceable, as is the case, for example, with contracts. However, laws that create or support federal liabilities do not always confer legally enforceable rights on recipient entities. Legal enforceability may provide additional evidence that a liability exists, but it is not a prerequisite.

Definition of a Liability

39. A liability is a present obligation[6] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

[6] The term *obligation* is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

40. The definition of a liability addresses only whether a liability exists and not how it should be measured or whether or when it should be recognized. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other considerations for recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

Essential Characteristics of Liabilities

41. Similar to the definition of an asset, the definition of a liability is derived from the nature of liabilities—that is, the essential characteristics without which a liability would not exist. A liability of the federal government has two essential characteristics, which are discussed in paragraphs 42 through 48. First, a liability constitutes a present obligation to provide assets or services to another entity. Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled.

Present Obligation

42. As the term is used in this Statement, an obligation is a duty or responsibility to act in a certain way. To have a *present* obligation means that the obligation arose as a result of a past transaction or other event and has not yet been settled. Thus, a present obligation should be distinguished from a mere expression of future intent, such as the government's announcement that it intends to acquire equipment. A present obligation is incurred when the government takes a specific action or an event occurs that commits or binds the government.

43. To meet the first essential characteristic of a liability, a present obligation must entail the provision of assets (cash, cash equivalents, or goods) or services to another entity in the future. For example, the government may have received from another entity goods or services that it has agreed to purchase but has not yet paid for, or it may have agreed to provide assets or services to another entity under certain conditions and those conditions have been met. In these situations the government has a present obligation to fulfill its commitments, even if the actual provision of assets or services is not required until a later date.

44. As indicated in the previous paragraph, for a present obligation to qualify as a liability of the Federal government, two separate entities must be involved.[7] Separate entities must be involved because the same entity cannot be both the recipient of settlement of a liability and the entity with the duty to settle. For example, when the government operates machinery, the government may have an obligation to maintain it. However, the obligation does not qualify as a liability for maintenance because the government cannot have a liability to itself. In contrast, if the government contracts for maintenance from another entity, it may have a liability to that other entity for the price of the maintenance services it has received.

Settlement of the Obligation

45. The second essential characteristic of a liability is that either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled. The timing of settlement often is expressed in contracts and other agreements as a specific or determinable date. However, in some cases the parties agree that settlement will be triggered by a specific event or by the demand of the recipient of the assets or services, the timing of which may be uncertain. If, at the reporting date, the government and the other entity do not have an agreement or understanding concerning settlement and the government is free to decide whether and when to settle its obligation, the obligation does not meet the definition of a liability.

46. In addition to uncertainty as to the timing of settlement, many present obligations involve uncertainty regarding the amount of settlement. For example, the amount required to settle the obligation may be contingent on the occurrence or non-occurrence of a future event, such as a decline in market prices. The government nevertheless is obligated to fulfill its obligation upon resolution of any contingencies affecting the timing and amount of settlement. Uncertainty regarding the amount or timing of settlement is addressed through measurement of the liability.

47. Frequently, the federal government knows before settlement is due which specific entities or individuals will receive settlement. However, such advance identification of specific recipients is not an essential characteristic of a liability. For example, the government may have a long-term disability agreement with federal employees without knowing the identity of each of the employees who ultimately will qualify for payment. The obligation qualifies as a liability if both of the essential characteristics of a liability are present.

[7] As indicated in paragraph 16, for a component entity the other entity could be another component entity. When component entities transact with each other, they are external to each other. Paragraph 14 explains that some items meet the definitions of elements from a component entity's perspective but not from the federal government's perspective. Such items would be reported in the accrual-basis financial statements of the relevant component entities but would be eliminated in consolidation and therefore would not be reported in the consolidated financial statements of the federal government.

48. Once incurred, a liability of the federal government continues as a liability until the government settles it or another event or circumstance discharges it or removes the government's responsibility to settle it.

Net Position, Revenues, and Expenses

49. Whereas the definitions of assets and liabilities derive from the essential characteristics of those items, the definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities. Thus, in assessing whether items meet the definitions of net position, revenues, and expenses, reference should be made to the definitions of their underlying assets or liabilities.

Definition of Net Position

50. Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

51. Entities often subdivide net position in financial reports to provide information about its composition. However, the reported composition and intended interpretation of net position depend on the particular financial reporting model applied and resulting display requirements. As such, a discussion of the meaning of the government's or a component entity's reported net position is beyond the scope of this Statement.

Definitions of Revenue and Expense

52. A revenue is an inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

53. An expense is an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

54. Common sources of revenues are charges and fees to other entities for goods or services; tax levies and other impositions; and donations. Expenses generally result from the provision of cash, cash equivalents, goods, and services to other entities. Transactions that are in substance adjustments or completions of previous transactions rather than new transactions involve the same elements as the original transaction. For example, a tax refund is considered a revenue reduction and not an expense, and reimbursement of one agency's expense by another agency is considered a reduction of an expense, not a

revenue, to the recipient agency and an expense to the reimbursing agency. The definitions of revenue and expense address only whether those elements exist. The definitions do not address how a revenue or expense should be measured or whether or when it should be recognized in the federal government's or a component entity's financial statements. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other considerations for recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

55. Existing standards or established practice may indicate that certain increases and decreases in assets should be reported as gains and losses, rather than revenues and expenses. Use of the terms *gains* and *losses* generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature[8] or their having resulted from peripheral or incidental activities of an entity.[9]

56. The definitions of revenue and expense in this Statement include items that might be reported as gains and losses. Gains and losses are considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets. Whether certain kinds of revenues and expenses should be reported as gains and losses and, if so, under what circumstances, is beyond the scope of this Statement.

Effects Of Uncertainty

57. Uncertainty about economic activities and results is pervasive. Uncertainty about whether a transaction or other event gives rise to the existence of an element means that judgment often is required as to whether the item possesses the essential characteristics of an element and therefore meets the relevant definition. Items that are judged to meet the definition of an element are candidates for recognition provided they are measurable—that is a monetary amount can be determined with reasonable certainty or is reasonably

[8] See, for example, Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 35 (FASAB, 1996).

[9] The latter distinction is included in FASB Concepts Statement 6, *Elements of Financial Statements,* par. 87 (FASB, 1985).

estimable. Items that, because of uncertainty, do not meet the basic recognition criteria may be candidates for disclosure.

58. In addition to the basic recognition criteria, decisions whether to recognize or disclose an item take into account considerations that also include uncertainties. These considerations are measurement of an appropriate attribute, which may include an assessment of the probability of future flows of economic benefits or services, and assessments of the materiality of the item and the benefit versus the cost of recognizing it.[10]

59. Uncertainty increases the costs of financial reporting, particularly the costs of recognition and measurement. Also, reassessments and restatements may be required if items previously reported as expenses or revenues, or not reported, are later found with benefit of hindsight to have the essential characteristics of assets or liabilities.[11] It may be possible to reduce uncertainty by exerting greater effort or spending more money, but it also may not be worth the added cost. As discussed in paragraph 6, the exercise of judgment may be necessary, but this Statement does not require certainty.

[10] As discussed in paragraph 7, measurement issues, probability assessments, and other considerations for recognition decisions beyond the basic recognition criteria are not addressed in this Statement. The Board intends to address those issues in future pronouncements. In the meantime, existing standards for those issues continue to apply.

[11] This Statement does not change existing standards concerning whether new information should result in restatement of previously reported information or should be treated prospectively as a change in estimate.

Appendix A: Basis for Conclusions

A1. This appendix summarizes important matters that FASAB considered 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background

A2. The FASAB developed a core set of accounting standards and initial concepts statements on reporting objectives and entity and display early in its first six years of operation. Concepts were developed as initial standards were developed. In 2003, the Board decided that it should review and add to or modify its concepts statements as needed. The Board's desire to evaluate its concepts after more than twelve years of successful progress is stimulated by a realization that (a) some critical concepts that have been relied on are not yet included in a concepts statement, (b) certain aspects of the concepts are not widely understood or accepted, and (c) an expansion or modification of its concepts statements will help the Board communicate more effectively with the growing community of federal financial report users, preparers, and auditors.

A3. As part of its project to review and expand its conceptual framework, the FASAB began deliberations on this Statement of Federal Financial Accounting Concepts (SFFAC), *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, in October 2003. This Statement defines the elements of federal accrual-basis financial statements and establishes basic criteria for selecting candidates for recognition in those statements. The Board believes that this Statement is an important part of its conceptual framework and will provide more consistent, useful, and enduring guidance to the Board and its constituents than establishing definitions and recognition requirements standard by standard.

A4. Part of the reason for this Statement is that, for several years, the Board has received questions about the usefulness of certain definitions of elements, such as liabilities, in current standards and their applicability to transactions outside the scope of the defining standard, as well as about the absence of definitions of other elements, such as assets. Moreover, in certain standards the Board requires disclosure or other required reporting of financial and non-financial information that does not meet the definition of an element and is not directly linked to an element—for example, social insurance cash flows, tax gap, acres of land, and current service assessments. In this Statement, the Board provides definitions of the elements of accrual-basis financial statements that will inform the Board's deliberations of future standards as well as providing guidance to preparers and auditors on issues that are not addressed in current standards. This Statement does not change existing standards. However, the Board intends to apply the definitions and basic recognition criteria in this Statement when it deliberates new standards and modifications of existing standards.

A5. The concepts, definitions, and basic recognition criteria in this Statement provide a common foundation for distinguishing between items that meet the definitions of elements of accrual-basis financial statements and those that do not, and between items that are candidates for recognition in the body of accrual-basis financial statements and those that qualify only for disclosure in the notes or as supplementary information. The Board therefore anticipates that the guidance in this Statement will enhance the understandability, consistency, and comparability of financial reporting for the benefit of users, preparers, and auditors of the financial statements as well as the Board itself. As a result, the Board expects this Statement to contribute to meeting the government's overall financial reporting objectives of demonstrating accountability and providing useful information, as well as the more specific objectives of assisting users in evaluating a reporting entity's operating performance and stewardship.

A6. The Board issued an Exposure Draft (ED) of this Statement in June 2006. The ED was circulated with a request for comments to more than 250 federal and nonfederal individuals and organizations, including financial statement preparers, auditors, and users; state-level taxpayer organizations; professional associations and journals; and U.S. and overseas standard-setting authorities. The Board received 40 comment letters and heard five presentations at a public hearing in September 2006. Respondents generally were supportive of the Board's proposals. This Appendix includes a discussion of the principal issues raised and the reasons for the Board's conclusions.

Definitions Of Elements In Existing FASAB Pronouncements

How Does This Concepts Statement Affect Existing Definitions in Statements of Federal Financial Accounting Standards?

A7. The following are definitions of *liabilities* and *revenues* included in federal financial accounting standards and a definition of *asset* included in the explanatory text of a federal financial accounting standard. Also, the Consolidated Glossary includes a different definition of *assets* and a definition of *expense*. However, those definitions are not included in any final Statement approved by the Board.

The term ***asset*** as used in this document means an item that embodies a probable future economic benefit that can be obtained or controlled by the federal government or a reporting entity as a result of past transactions or events. (The definition of assets will be considered by the Board in the future.)—SFFAS 1,[12] Basis for Conclusions, par. 93

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, Concepts Statement No. 6, *Elements of Financial Statements* [FASB CON 6])—Consolidated Glossary

A ***liability*** for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.—SFFAS 5,[13] par. 19

Revenue is an inflow of resources that the Government demands, earns, or receives by donation.—SFFAS 7,[14] par. 30

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.[15]—Consolidated Glossary

A8. Concepts statements do not establish generally accepted accounting principles (GAAP) and cannot amend existing standards, interpretations, technical bulletins or releases, or staff implementation guidance. The GAAP hierarchy provides that statements of federal financial accounting standards constitute level A (the highest level) guidance. Statements of federal financial accounting concepts are not GAAP. Instead, concepts statements constitute "other literature" and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature. In developing and amending accounting standards, the Board looks to concepts statements for guiding principles and also considers relevant existing standards and guidance issued by the Board

[12] Statement of Federal Financial Accounting Standards 1, *Accounting for Selected Assets and Liabilities*, 1993.

[13] Statement of Federal Financial Accounting Standards 5, *Accounting for Liabilities of the Federal Government*, 1995.

[14] Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, 1996.

[15] Adapted from FASB CON 6.

and other standard-setting bodies. Until the Board amends existing standards, the Board expects practice to be governed by the definitions embodied in the four levels of the GAAP hierarchy. Thus, the Board distinguishes between definitions presented in concepts, which are used to guide Board deliberations on future GAAP, and definitions presented in standards, which constitute current GAAP.

A9. For example, SFFAS 5, *Accounting for Liabilities of the Federal Government*, provides and will continue to provide authoritative general guidance on liability recognition and measurement in the absence of more specific liability standards. SFFAS 5 provides the general liability definition presented in paragraph A7 and general standards regarding recognition of liabilities in four classes—exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events. It also provides specific standards for contingencies; capital leases; federal debt and related interest; pensions, other retirement benefits, and other postemployment benefits; and insurance and guarantees (excluding loan guarantees). Specific standards regarding liabilities also exist in SFFAS 1, 2 (as amended by 18 and 19), 6, and 12.

A10. The Board's—and the profession's—expectation is that standards will continue to be applied until they are amended or rescinded. It is widely recognized that GAAP guidance at any point in time may contain provisions that are inconsistent with concepts. Because concepts are not GAAP and are to be considered only in the absence of GAAP, any inconsistency of definitions should not cause a different outcome as the GAAP definitions would be applied.

A11. The Board does not expect specific classes of transactions or other events to qualify or not qualify as elements as a result of this new set of element definitions. However, the definitions are expected to guide the Board's future deliberations, which may lead to future changes in practice through new or amended standards of federal accounting and financial reporting. The Board plans to consider how the element definitions should be applied in each standard-setting project undertaken. Projects may include both new specific standards and amendments to existing standards. The Board solicits input on its agenda prior to adding new projects. This Statement will help respondents contribute input by providing a framework for identifying any inconsistencies in current standards.

What General Improvements Are Gained by the Adoption of This Concepts Statement?

A12. The Board believes that the definitions in this concepts statement will better support the Board's future deliberations by providing for the first time:

a. *Internally consistent definitions for all of the elements of accrual-basis financial statements*, some of which are not defined in current GAAP and all of which have been subject to due process; and

b. *Explanatory text for each definition* to assist the Board in application of the definitions. For example, the discussion of essential characteristics is intended to enhance the clarity of the definitions and the consistency of their interpretation and application by the Board.

A13. In addition, the concepts statement responds to the following general concerns that were raised regarding the prior asset and liability definitions:

a. *Potential confusion concerning the use of "probable" in both definitions*. For example, there are various thresholds applied in practice and there is difficulty in establishing at the financial reporting date what future flows will result.

b. *Potential redundancy and confusion about inclusion of the concept of past transactions or events that create assets and liabilities.* Some view this inclusion as redundant because the asset or liability exists and thus a past transaction or event must have occurred. Some believe the inclusion causes confusion about what assessment is being made: whether the characteristics of an asset or liability exist or whether there was a qualifying past event. The Board believes that the concepts of "resource embodying economic benefits" (asset) and "present obligation" (liability) better convey the intended meaning.

c. *Potential confusion concerning the use of the terms "future outflow" and "future economic benefit."* Some confusion may exist in the use of the word "future" when an asset is a resource that the government controls today and a liability is a present, not a future, obligation. The Board believes that the definitions in this concepts statement convey a more clear understanding.

d. *Clarification concerning settlement*. The Board believes that it is important to clarify, as an essential characteristic, that for a liability to exist at the reporting date, there must be a law or an agreement or understanding concerning settlement. If at the reporting date the government is free to decide whether and when to settle the obligation, the government does not have a liability.

Approach to Defining Elements

Assets and Liabilities

A14. The Board's approach to defining assets and liabilities is to identify the essential characteristics of those elements—that is, the characteristics that *all* assets and *all* liabilities, respectively, possess and without which they would not exist. The definitions of assets and liabilities established in this Statement are designed to capture those essential characteristics succinctly. However, the definitions considered without further explanation could be interpreted differently. To enhance the clarity of the definitions and the consistency of their interpretation and application, the Board has included in the Statement a discussion of the essential characteristics underlying each definition. The Board encourages those who read and apply this Statement to consider the definitions and the subsequent discussions of essential characteristics as a "package," rather than considering the definitions in isolation of further explanation.

A15. The principal advantage of the Board's approach to defining assets and liabilities is that it enhances objectivity and consistency in establishing standards and in practice in the absence of guidance at a higher level within the hierarchy. Whether an asset or liability results from a particular transaction or other event can be determined objectively and consistently by the Board, preparers, and auditors by comparing the item to the definition of an asset or liability and considering whether the item has the essential characteristics of that element. The alternative approach whereby the Board decides standard by standard what activities result in assets or liabilities may result in a lack of objectivity and inconsistent treatment of similar transactions or other events. A large majority of the respondents to the ED agreed with the Board's approach to defining assets and liabilities.

Net Position, Revenues and Expenses

A16. The Board has concluded that the elements net position, revenues, and expenses are not independent of assets and liabilities and do not have their own essential characteristics. Net position is total assets less total liabilities. Revenues and expenses are changes in assets and/or liabilities during a reporting period that result in a change in net position. Thus, the definitions of all three elements are dependent on the definitions of assets and liabilities.

A17. Some people believe that a conclusion that the definitions of revenues and expenses derive from the definitions of assets and liabilities indicates that assets and liabilities are more important than revenues and expenses. They believe that, by extension, a "stocks" statement, such as a statement of financial position or balance sheet, will be considered the principal statement in a financial report and a "flows" statement, such as an activities statement or statement of net cost, will be secondary in importance. Many of those with these views disagree with the perceived primacy of "stocks" statements and believe that "flows" statements are either equally important or more important in government financial reporting.

A18. The Board disagrees that the derivation of the definitions of revenues and expenses from the definitions of assets and liabilities accords more importance to a statement of financial position or balance sheet than to an activities statement. Each type of statement has its own purposes. Conceptually, they are equally important. However, the relative importance that users give to one type of statement versus the other may vary depending on the decisions that users wish to make in particular circumstances and, therefore, on the information they are seeking. The two types of statements are related. They articulate, just as revenues and expenses articulate with assets and liabilities. Assets and liabilities represent real-world phenomena, such as cash, equipment, and debt, and can be defined by the characteristics that all assets and liabilities, respectively, share. Revenues and expenses do not have characteristics that are independent of assets and liabilities. Rather, they are accounting and financial reporting constructs that measure and report the effects of activities during a reporting period on the amounts of assets and liabilities at the beginning of the period. Without assets and liabilities, revenues and expenses do not exist. They cannot be defined without reference to assets and liabilities or similar concepts such as "resources" and "obligations." A large majority of the respondents to the ED agreed with the Board's approach to defining net position, revenues, and expenses. The Board notes that its view of the relationship between revenues and expenses and the definitions of assets and liabilities is shared by most other major standard setters in the United States and overseas, including those that promulgate standards for the public sector as well as the business sector.

Definitions, Recognition, and Measurement

A19. The Board's approach in this Statement also separates the path to recognition on the face of financial statements into three components: meeting the definition of an element, meeting recognition criteria, and measurement of the item to be recognized. Although the components may be addressed simultaneously in practice, the Board believes that a conceptual distinction is useful. It clarifies that an item that meets the definition of, for example, an asset is an asset, even if it does not meet the criteria for recognition in the body of the financial statements, or it is not material, or it is not cost-beneficial to report the item in the financial statements or notes or as supplementary information. The item remains an asset until it is disposed of or no longer meets the definition of an asset.

A20. The recognition criteria established in this Statement ("basic recognition criteria," as discussed later) include a conclusion as to whether the asset is measurable, meaning that a monetary amount can be determined with reasonable certainty or is reasonably estimable. The basic recognition criteria do not include requirements for the actual measurement of an element. Measurement includes selecting an appropriate attribute (historical cost, fair value, expected value, or some other attribute) and quantifying it monetarily using an appropriate measurement method, which may include an assessment of the probability of future flows of economic benefits or services. Recognition decisions also include consideration of the materiality of the amount measured and the cost-benefit of reporting it. The scope of this Statement includes definitions of elements and the establishment of basic recognition criteria, but it does not include measurement requirements. The Board intends to address measurement issues in a separate pronouncement.

Modifications to the Exposure Draft

Probability Assessments and Thresholds

A21. The Board had numerous discussions about the role of probability assessments in determining whether an item meets the definition of an element and/or is measurable for financial reporting purposes. The Board's decision in the ED was that judgment might be required in determining whether an item meets the definition of an element and is recognizable in the body of financial statements. However, an assessment of probabilities was not included as a mandatory component of determining compliance with the definition of an element or basic recognition criteria, although such an assessment was not precluded. Rather, an assessment of probabilities should be made, if appropriate, when measuring the item to be recognized.

A22. Three Board members presented an alternative view. These members were concerned that, by not requiring probability assessments, the ED implied that items with a low probability of meeting the definition of an element or of meeting the recognition criteria could be recognized in the financial statements. In their view, the Board should specifically state that an assessment of probabilities should be made as part of determining whether an item meets the definition of an element. Similarly, the probability that an item is measurable should be assessed when considering whether a candidate for recognition is measurable. Also, the Board should acknowledge that there exists a threshold at both the definition and the recognition stages where the probability of meeting the definition and recognition criteria is so low that an item should be considered not to meet the definition of an element or the recognition criteria.

A23. Respondents to the ED were evenly divided in their support for the ED (majority) view or the alternative view concerning probability assessments and probability thresholds. The reasons given were similar to those expressed respectively in the ED and the alternative view. After further deliberation, the Board reaffirmed its decision that probability assessments should not be required when determining compliance with definitions or recognition criteria and the potential existence of probability thresholds should not be mentioned; the Board would address probability assessments and consider potential thresholds in a future project on measurement. However, the Board decided that references to recognition criteria in paragraph 5 and elsewhere should be modified to indicate more clearly that the Statement does not address all matters to be considered in recognition decisions. Also, the references to uncertainty about the existence of an element and whether it is measurable should be clarified.

A24. As a result, paragraph 5 and related discussions now refer to “basic recognition criteria” and identify additional considerations for recognition decisions to be addressed in one or more future pronouncements. “Basic recognition criteria” are defined in paragraph 5 as “the conditions an item should meet in order to be a candidate for recognition.” The Board also has expanded the definition of “measurable” in paragraph 5 to mean “a monetary amount can be determined with reasonable certainty or is reasonably estimable.” In the section on “Effects of Uncertainty” (paragraphs 57 through 59) the Board has clarified aspects of uncertainty in financial reporting and modified the discussion to achieve greater consistency with the revised paragraphs 5 through 8 under “Recognition.”

Qualitative Characteristics

A25. The members with an alternative view on the location of probability assessments also presented an alternative view concerning the qualitative characteristics of information in financial reports. These members said that the ED should explicitly acknowledge that the qualitative characteristics—or at a minimum the characteristics of relevance and reliability—should be considered when determining whether an item meets the definition of an element and is measurable. The majority of the Board, however, indicated that the proposed concepts Statement on elements mentioned the qualitative characteristics in paragraph 1 and did not supersede or change the applicability of those characteristics in accordance with SFFAC 1.[16] Past practice of the FASAB has been not to repeat in new statements of concepts or standards the content or requirements of prior statements that the new statement does not supersede. Those requirements automatically continue until superseded by a new pronouncement. Therefore, to repeat the qualitative characteristics in the elements ED was unnecessary and might be confusing to readers of the ED accustomed to the FASAB’s past practice in this area by implying that the qualitative characteristics established in SFFAC 1 had been changed. Respondents to the ED were slightly more in favor of the alternative view than the ED (majority) position on this issue. However, the Board concluded that the alternative view might have unintentionally implied that the qualitative characteristics need not be considered unless they were specifically repeated in the elements statement.

A26. The Board reaffirmed its decision not to list the qualitative characteristics in the Statement or to refer specifically to their applicability to definition and recognition decisions. Nevertheless, the Board decided to clarify the issue in the elements Statement. As a result, the Board has (a) expanded the discussion of the role of this Statement in the Board’s conceptual framework and the continuity of prior concepts statements (See the page on “Statements of Federal Financial Accounting Concepts” placed before the Table of Contents.), (b) highlighted the reference to qualitative characteristics in paragraph 8, and (c) added the definition of “Qualitative Characteristics” to the Glossary (Appendix B) with a cross-reference to the identification of them in paragraph 156 of SFFAC 1.

[16] Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* 1993.

Applicability of Existing Conditions, Including Current Law

A27. Paragraph 44 of the ED states that

> To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on *existing* conditions, including current law, because an essential characteristic of a liability is that the government has a *present* obligation, even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability.

A28. Three Board members presented an alternative view to the effect that "the government's power to modify the law to change or withdraw future benefits related to nonexchange transactions could affect the existence of a present obligation. Consequently, . . . the government's ability to change the law may provide additional evidence about whether a present obligation exists and, in some instances, may preclude recognition of a liability."

A29. A large majority of the respondents to the ED on this issue supported the position in paragraph 44 of the ED for reasons similar to those stated in that paragraph—primarily that "liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred." Some respondents noted that, given the broad power of Congress, if its ability to change the law precluded the existence of a liability, then the government would have very few liabilities. Respondents who supported the alternative view generally geared their responses to the reference in the alternative view to "future benefits related to nonexchange transactions." Some of these respondents said that obligations for such benefit programs are different from other obligations, or that the government has no contractual commitment or present obligation for future benefits, or that the government's ability to change the law "could affect the existence of a present obligation," as stated in the alternative view.

A30. The Board redeliberated and clarified that the concepts embodied in paragraph 44 of the ED apply equally to all elements. Consequently, the scope of the discussion in paragraph 44 has been broadened and the paragraph has been moved to the beginning of the section addressing definitions of elements. The following paragraph is presented there:

> 17. Assessments of whether an item meets the definition of an asset, liability, revenue, or expense are based on conditions that exist at the reporting date, including current law,

because all elements of accrual-basis financial statements are based on transactions or events that already have occurred. Therefore, if an item meets (or does not meet) the definition of an element under the conditions in effect at the reporting date, the power of the government to subsequently change those conditions does not eliminate (or create) an element at the reporting date. For example, if an item meets the definition of a liability at the reporting date, the power of the government to subsequently change the law so that the item no longer meets the definition does not eliminate the existence of the liability at the reporting date.

The revised paragraph relates the concept to all elements and considers both items that meet as well as those that do not meet the definition of an element at the reporting date. The Board further emphasized that the provisions of paragraph 17 are intended to address the effects of Congressional prerogative to change laws generally and not the potential effects on specific federal programs. This Statement, in common with most concepts statements, does not address specific programs. Conclusions regarding specific programs are issues for separate projects. Some members observed that the possibility or probability of a change in the law might be taken into account in measuring a liability or other elements of the financial statements. Most members also believed that such a possibility also could be disclosed.

Definition of Assets

A31. A large majority of the respondents to the ED agreed with the essential characteristics of assets identified by the Board and that the Board's definition of assets adequately conveys those characteristics. Further, they did not identify any additional characteristics that are essential to all assets. Two respondents, while agreeing with the definition of assets, questioned whether the requirement in the definition that the government "can control" the economic benefits or services embodied in an asset should be changed to "controls" the economic benefits or services. The respondents were concerned that "can control" might be construed as applying only to the future, whereas they believe the government should be controlling the economic benefits or services at the reporting date. The Board reconsidered the issue. Some members believe that "controls" may be interpreted to mean that the Board must be *actively controlling* access to the economic benefits or services at the reporting date, which is not an essential characteristic of an asset. Rather, the essential characteristic is the government's *ability* to control access. For example, the government might be willing currently to allow other entities free access to the economic benefits or services embodied in its asset, without relinquishing its right to regulate or deny that access and obtain the benefits exclusively for the government. In contrast, other members believe and the Board concluded that "controls" incorporates the ability to exercise or waive its active control of the access to economic benefits. The Board therefore revised the definition of an asset (paragraph 18) to read:

An asset is a resource that embodies economic benefits or services that the federal government controls.

Conforming modifications have been made to the paragraphs describing the essential characteristics of assets.

Definitions of Revenues and Expenses

A32. The Board proposed the following definitions of revenues and expenses in the ED:

52. A revenue is an increase in assets, a decrease in liabilities, or a combination of both from providing goods or services, levying taxes or other impositions, receiving donations, or any other activity (excluding borrowing) performed during the reporting period.

53. An expense is a decrease in assets, an increase in liabilities, or a combination of both from providing cash or cash equivalents, goods or services, or any other activity (excluding repayments of borrowing) performed during the reporting period.

A large majority of respondents to the ED agreed that the definitions adequately convey the relationship of revenues and expenses to assets and liabilities. Respondents generally did not comment on the actual definitions. However, a few respondents suggested clarifications or simplifications, such as referring to changes in net position instead of to increases or decreases in assets and liabilities, clarifying or avoiding the reference to borrowings, and clarifying the phrase “any other activity.”

A33. The Board agreed that referring to changes in net position would remove the need to refer to the exclusion of borrowings and repayments of borrowings. Also, the Board concluded that the reference to “any other activity” lacked clarity and effectively made the definitions all-encompassing. The Board decided to simplify the definitions and has included the following wording in this Statement:

52. A revenue is an inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government’s net position during the reporting period.

53. An expense is an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government’s net position during the reporting period.

The Board has included examples of revenues and expenses in paragraph 54 instead of in the definitions. The Board also has confirmed in paragraph 54 that transactions that are in substance adjustments or components of previous transactions would use the same element as the original transaction. For example, tax levies would be reported as revenues and tax refunds would be reported as reductions of revenues, not expenses.

Other Issues Raised By Respondents

Definition of Liabilities

A34. A large majority of the respondents to the ED agreed with the essential characteristics of liabilities identified by the Board and that the Board's definition of liabilities adequately conveys those characteristics. Further, they did not identify any additional characteristics that are essential to all liabilities. Nevertheless, a few respondents thought that an agreement or understanding between the parties concerning settlement of the obligation is not an essential characteristic of a liability, or is part of the "present obligation" characteristic.

A35. The Board discussed the "settlement" characteristic before issuing the ED and concluded that if the government *alone* can determine whether and when to settle an obligation then it does not qualify as a liability. A liability always is between two separate entities. There must be either an obligation and a requirement for settlement with the other entity supported in law or some agreement or "meeting of the minds" between the government and the other entity as to whether an obligation exists and what circumstances would trigger settlement. The Board believes that the respondents who disagreed that the "settlement" characteristic is an essential characteristic of a liability may have inferred that the FASAB was saying that the *precise* timing of settlement must be specified and agreed between the two parties. However, that was not the Board's intent. As stated in paragraph 45:

> . . . The timing of settlement often is expressed in contracts and other agreements as a specific or determinable date. However, in some cases the parties agree that settlement will be triggered by a specific event or by the demand of the recipient of the assets or services, *the timing of which may be uncertain*. If at the reporting date the government and the other entity do not have an agreement or understanding concerning settlement *and the government is free to decide whether and when to settle the obligation*, the government's obligation does not meet the definition of a liability. (emphasis added)

A36. Paragraph 46 indicates that both the timing and the amount of the settlement may be uncertain, but that "Uncertainty regarding the amount or timing of settlement is addressed through measurement of the liability." The Board does not believe that there is uncertainty about whether the government has a liability simply because the precise settlement date is unknown. For example, with respect to unresolved litigation, the date of settlement may be unknown. Based on these considerations, the Board reaffirmed its conclusion that an essential characteristic of a liability is that the government be legally required to make settlement with the other entity or the government and the other entity have an agreement or understanding concerning settlement.

Additional Elements

A37. A few respondents to the ED suggested that certain items that the Board had concluded meet the definitions of revenues or expenses should be defined as separate elements. Those items and the number of respondents who suggested them are gains and losses (4 respondents), appropriations (2 respondents), intra-governmental transfers (3 respondents), and imputed costs (1 respondent). Also, two respondents proposed that the currently reported components of net position—unexpended appropriations and cumulative results of operations—should be defined as separate elements. In its deliberations leading to the ED, the Board concluded that these items are subdivisions of net position according to a particular financial reporting model and should not be considered separate elements.

A38. With respect to gains and losses, the Board reviewed the practice of other standard setters prior to issuing the ED and found that some define gains and losses as separate elements whereas others do not. Regardless of whether they are defined separately from revenues and expenses, the reporting of gains and losses generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature or their having resulted from an entity's peripheral or incidental activities. The Board has concluded that, conceptually, gains and losses are subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are subsets of assets. The Board believes that whether and under what circumstances certain items should be displayed in the financial statements as gains and losses rather than revenues and expenses is an issue for financial reporting standards.

A39. SFFAS 7[17] defines appropriations and transfers as other financing sources, rather than revenues. However, the standard states that other financing sources are inflows of resources like revenues. Moreover, in practice, many component entities regard appropriations as revenues, regardless of whether they are referred to as other financing sources in certain statements. The Board believes that, as with gains and losses, the distinction between other financing sources/uses and revenues/expenses is not a true conceptual distinction. Rather, it is attributable to display considerations under a particular financial reporting model. As such, the Board has concluded that other financing sources, such as appropriations and transfers, are not separate elements from revenues. Appropriations are not revenues of the government as a whole. However, they are like revenues for component entities because they provide the legal basis for the entities to incur expenses.

[17] Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, 1996.

A40. FASAB Interpretation 6[18] states the following:

> 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).

Consistent with this definition, the Board has concluded that imputed costs are not separate elements, but are included in the definition of expenses for component entities.

A41. The Board does not consider unexpended appropriations and cumulative results of operations to be separate elements. Rather, they are components of net position in the current federal financial reporting model. To define them as elements in this Statement would imply that the definitions in this Statement are designed to apply to the current reporting model and may not be applicable to other models. On the contrary, the Board concluded at the outset of the elements project that the definitions and related concepts in this Statement should not be geared or restricted to any particular financial reporting model because that would constrain the Board's ability to modify the model to meet the changing or emerging needs of decision makers. For these reasons, the Board has not included definitions of unexpended appropriations or cumulative results of operations in this Statement and has not discussed their role in financial reporting.

Board Approval

A42. The Board adopted this Statement by the affirmative votes of eight members. Mr. Werfel and Mr. Steinberg abstained.

A43. Mr. Steinberg, as a new member of the Board, did not participate in the Statement's development and has abstained. He is concerned, nevertheless, that the Statement does not provide sufficiently for the manner in which the federal government and its agencies meet the financial reporting objectives already established by the Board. He points out that with the federal government the preponderance of financial reporting is through the individual agencies' financial statements, not the financial statements for the government as a whole. In not recognizing that approach, some of the most significant items in the financial statements, i.e., expended appropriations, unexpended appropriations, and imputed financing, are not sufficiently addressed, even though they are among the most important items in the financial statements. He also points out that the Statement limits itself to elements of accrual-basis financial statements even though there are four objectives for federal financial reporting, the first of which is Budgetary Integrity, and one of the financial

[18] Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4,* 2003.

statements required by generally accepted accounting principles is a budget basis financial statement.

Appendix B: Glossary

Asset: A resource that embodies economic benefits or services that the federal government controls.

Basic recognition criteria: The conditions an item should meet in order to be a candidate for recognition in financial statements.

Control: The ability of the federal government or a component entity to obtain the economic benefits or services embodied in a resource and to deny or regulate the access of others.

Elements: The broad classes of items, such as assets, liabilities, revenues, and expenses, which comprise the building blocks of financial statements.

Essential characteristic of an asset (or a liability): A characteristic that is inherent to all assets (or liabilities) and, therefore, without it an asset (or liability) would not exist.

Expense: An outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

Liability: A present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

Net position: Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

Measurable: A monetary amount can be determined with reasonable certainty or is reasonably estimable.

Measurement: The act or process of measuring; a figure, extent, or amount obtained by measuring.

Qualitative characteristics: The basic characteristics that information in financial reports must have in order to communicate effectively with users. These characteristics are understandability, reliability, relevance, timeliness, consistency, and comparability.[19]

[19] SFFAC 1, par. 156.

Recognition: The process of formally recording or incorporating an element into the financial statements of an entity. Recognition comprises depiction of an item in both words and numbers with the amount included in the totals of the financial statements.

Resource: A useful or valuable possession or quality of a country, organization or person; a means of supplying a want.

Revenue: An inflow of or other increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

Appendix C: Generally Accepted Accounting Principles

Excerpt from the AICPA's AU Section 411 - The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles

05. Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles that are generally accepted in the United States of America are—

a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 [ET section 203.01] of the AICPA Code of Professional Conduct. Rule 203 [ET section 203.01] provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 [ET section 203.01] implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 [ET section 203.01] provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. (See section 508, Reports on Audited Financial Statements, paragraphs .14 and .15.)

b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a). fn 2

c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.

d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

[Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.]

06. Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.

07. If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 [ET section 203.01], the auditor should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (b), (c), or (d) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (b), (c), or (d), the auditor should follow the treatment specified by the source in the higher category—for example, follow category (b) treatment over category (c)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

08. The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. Section 544, Lack of Conformity With Generally Accepted Accounting Principles, paragraph .04 and section 623, Special Reports provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

09. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.

[Paragraphs .10 through .13, Application to State and Local Government and Not-for-Profit Entities, omitted]

Application to Federal Governmental Entities

14. For financial statements of federal governmental entities—fn 8

    a. Category (a), officially established accounting principles, consists of Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to federal governmental entities by FASAB Statements or Interpretations. FASAB Statements and Interpretations will be periodically incorporated in a publication by the FASAB.

    b. Category (b) consists of FASAB Technical Bulletins and, if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position. fn 9

    c. Category (c) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

    d. Category (d) includes implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

[Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

15. In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of a federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in categories (a) through (d) of paragraph .10 when not specifically made applicable to federal governmental entities by the FASAB; FASB Concepts Statements; GASB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

Effective Date

16. This section is effective for audits of financial statements for periods ending after March 15, 1992. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

Transition

17. Most of the pronouncements or practices in categories (b), (c), and (d) of paragraphs .10 and .12 had equal authoritative standing prior to the issuance of this section. An entity following an accounting treatment in category (c) or (d) as of March 15, 1992, need not change to an accounting treatment in a category (b) or category (c) pronouncement whose effective date is before March 15, 1992. For example, a nongovernmental entity that followed a prevalent industry practice (category (d)) as of March 15, 1992, need not change to an accounting treatment included in a pronouncement in category (b) or (c) (for example, an accounting principle in a cleared AICPA Statement of Position or AcSEC Practice Bulletin) whose effective date is before March 15, 1992. For pronouncements whose effective date is subsequent to March 15, 1992, and for entities initially applying an accounting principle after March 15, 1992 (except for FASB Emerging Issues Task Force consensus positions issued before March 16, 1992, which become effective in the hierarchy for initial application of an accounting principle after March 15, 1993), the auditor should follow the applicable hierarchy established by paragraphs .10 and .12 in determining whether an entity's financial statements are fairly presented in conformity with generally accepted accounting principles. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

Statement of Federal Financial Accounting Concepts 6: Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information

Status

Issued	February 4, 2009
Affects	SFFAC 2, specifically, par. 2, 3, 55 (replaced), 69, 72 (rescinded), 74, 76, 77, 78, 79, 81 (rescinded), and 108, and footnotes 11, 12, 12a, 14, and 17. Also, section titled, “Displaying Financial Information.”
Affected by	None.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.pdf).

Summary

This Statement amends SFFAC 2, *Entity and Display*, to provide guidance for use by the Board in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI). Although each of these categories communicates information to readers of financial reports, each may be subjected to different procedures and reporting requirements under generally accepted government auditing standards. The Statement defines the categories as follows:

> **Basic information** is essential for the financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).
>
> **RSI** is information that a body that establishes GAAP requires to accompany basic information.
>
> **OAI** is information that accompanies basic information and required supplementary information, but is not required by a body that establishes GAAP.

This Statement describes the process the Board may apply in selecting one of these categories for communicating an item of information. The process begins with determining what information should be required. A candidate for required information is consistent with the reporting objectives and meets qualitative characteristics and cost-benefit considerations discussed in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*.

Information that meets the criteria for required information is a candidate for basic information or RSI. To help distinguish basic information from RSI, this Statement provides a list of factors that the Board may consider.

Information that does not meet the criteria for required information is a candidate for OAI. Entities may report OAI to support required information or to comply with laws or administrative directives. The Board may encourage OAI to help advance overall federal financial reporting.

Table of Contents

Introduction

Purpose

1. The existing conceptual framework provides guidance on what information should be reported and identifies a number of methods that may be used to communicate this information within a general purpose federal financial report (GPFFR).[1] For example, Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, provides guidance on the information that should be reported and SFFAC 2, *Entity and Display*, discusses the financial statements and other methods that may be used to provide the information and which entities should prepare them. In addition, SFFAC 3, *Management's Discussion and Analysis*, describes the management's discussion and analysis (MD&A) of significant topics.

2. Given the various alternatives for communicating information, this Statement expands the existing conceptual framework. This Statement amends SFFAC 2 to discuss a process and factors the Board considers when deciding whether the information should be considered basic information, required supplementary information (RSI), or other accompanying information (OAI). Discussing each of these categories may help those engaged in federal financial reporting to better understand the nature of the information being communicated and their importance to the financial reporting objectives.

Concepts

Scope

3. This Statement specifically affects SFFAC 2, par. 2, 3, 55, 69, 72, 74, 76, 77, 78, 79, 81, and 108, and footnotes 11, 12, 12a, 14, and 17. Also, this Statement affects the section of SFFAC 2 titled, "Displaying Financial Information."

[1]The term general purpose federal financial report, abbreviated "GPFFR" is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report is known as the Performance and Accountability Report or the Agency Financial Report.

Definitions

4. Required Information: Information that consists of basic and required supplementary information.

   a. Basic Information: Information that is essential for financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).

   b. Required Supplementary Information: Information that a body that establishes GAAP requires to accompany basic information.

5. Other Accompanying Information: Information that accompanies basic information and required supplementary information, but is not required by a body that establishes GAAP.

Amending SFFAC 2 to Distinguish Basic Information, RSI, and Other Accompanying Information

6. SFFAC 2, par. 2 is amended as follows.

   The purpose of this statement of accounting concepts is to provide guidance as to what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there ought to be financial reports (hereinafter called reporting entities), establishes guidelines for defining the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, ~~and~~ suggests the types of information each type of report would convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

7. SFFAC 2, par. 3 is amended as follows.

   A statement of financial accounting concepts is intended to guide the members of the Federal Accounting Standards Advisory Board (FASAB) as they deliberate ~~and recommend~~ accounting standards for the federal government. The concepts in this Statement are consistent with those established in SFFAC 1 which are not superseded or modified by this Statement. The concepts in this Statement also are generally consistent with current practice and do not imply radical change. However, they are expected to guide the Board's future deliberations. In addition, concepts statements constitute “other literature” and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature. ~~It~~ This Statement also would be useful to the Office of Management and Budget (OMB), when it carries out its statutory responsibilities for specifying who should prepare financial statements and the form and content of those statements~~; and as broad guidance for preparers, auditors, and users of financial statements of Federal agencies. A statement of financial accounting concepts does not, in and of itself, represent standards that would be considered generally accepted accounting principles for Federal agencies to be followed for the preparation of financial statements.~~

8. SFFAC 2, par. 55 is replaced by the following two paragraphs.

55a. To enhance confidence in the reliability of information presented in financial statements, the statements are often, but not always audited by Inspectors General, independent accounting firms, or the Government Accountability Office. In developing accounting standards, the Board considers whether information should be categorized as basic information, required supplementary information (RSI), or other accompanying information (OAI). Distinguishing these categories is important because each category is subject to different procedures and reporting requirements under generally accepted government auditing standards (GAGAS). When an auditor is engaged to audit an entity's financial statements, basic information as a whole is subject to testing for fair presentation in conformity with GAAP. However, RSI and OAI are unaudited, but subject to certain procedures specified by GAGAS for RSI and OAI, respectively. To assist users in analyzing the different types of information within financial reports, these differences must be conveyed and can be accomplished in a variety of ways. The traditional approach is to separate the categories of information. However, the categories may be commingled if the RSI and OAI are clearly labeled as “unaudited” or distinguished in a manner that informs the reader of the level of assurance provided.

55b. Classification of the information as basic information, RSI, or OAI does not constrain the form of presentation. For example, financial statements may be presented as basic financial statements, RSI, or OAI. Information can be required or encouraged to be in the form of financial statements, narrative, graphs, or tables. To clearly communicate the intended status, the Board must specify whether the information is to be considered basic information, RSI, or OAI. Selecting a category may involve a process which is described in paragraphs 73A to73G.

9. SFFAC 2, footnote 11 is rescinded.

10. SFFAC 2, footnote 12 is rescinded.

11. SFFAC 2, paragraph 72 is rescinded.

12. SFFAC 2, footnote 12a is amended as follows:

    The Statement of Financing may be presented as a financial statement or as a schedule in the notes to financial statements. The OMB will provide guidance regarding details of how the information will be displayed ~~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.~~

13. SFFAC 2, paragraphs 69, 74, 79 and 108 are amended to conform the term “management discussion and analysis” to the term established in SFFAC 3 - “management's discussion and analysis” - each time it appears in these paragraphs.

14. The following headings, paragraphs, and table are added to SFFAC 2, following paragraph 73.

Distinguishing Basic Information, RSI, and OAI

Determining Required Information

73A. Selecting a category for communicating information may involve a process that begins with determining what information should be required. Required information is information that consists of basic information and RSI. An item of information is a candidate for required information if it is consistent with the objectives of federal financial reporting and meets certain qualitative characteristics and cost-benefit considerations. The Board developed these factors earlier in the conceptual framework. SFFAC 1 identifies the reporting objectives (paragraphs 112 to 150) and the qualitative characteristics (paragraphs 157 to 164). It also discusses cost versus benefit considerations (paragraphs 151 to 155).

Determining Basic Information versus RSI

73B. Information that meets the criteria for required information is a candidate for basic information or RSI. Basic information is information which is essential for the financial statements and notes to be presented in conformity with GAAP. The FASAB standards are the core[2.1] of GAAP and auditors may be engaged to express an opinion as to

[2.1] The first and highest level of the GAAP hierarchy comprises standards and interpretations. Lower level GAAP may not conflict with standards or interpretations.

whether basic financial statements and notes are presented in conformity with those criteria.

73C. RSI is information that a body that establishes GAAP requires to accompany basic information. It may be experimental in nature to permit the communication of information that is relevant and important to the reporting objectives while more experience is gained through resolution of accounting issues. Also, the information may be expressed in other than financial measures or may not be subject to reliable estimation. As issues are resolved, the information may be considered basic at some point in the future.

73D. The Board specifies what information should be presented as basic information and what information should be presented as RSI. Assessing whether required information is a candidate for basic information or RSI may involve the Board's consideration of a range of factors which are listed in Table 1: Factors to Consider in Distinguishing Basic Information from RSI on page 230. The factors are not listed in a particular order and some may convey similar ideas. In addition, different Board members may assign different weight to each factor. Thus, the factors provide a general framework for each Board member's judgment and are not considered to present a decision tree, hierarchy, or precise algorithm for classifying items.

73E. For example, members may consider the relevance of the information to fair presentation. If the information has a high relevance to fair presentation, it may be a candidate for basic information communicated by financial statements and notes to the financial statements. The financial statements and notes could not be considered fairly presented if the information is missing or materially misstated. The rationales for some of the other factors that members may consider are:

a. Use of various types of financial data or financial transaction data. Members may deliberate the nature of the data used or the type of system used to process the information. Financial data used or data derived from a system for processing financial transactions, may be more likely to be considered basic information.

b. Level of importance the Board wishes to be communicated in the financial report or the auditor's report. In addition to the nature of the information, the Board may take into account the effect of categorizing an item as basic information or RSI in the financial report and what the auditor's report would communicate if the item is missing or materially misstated. By designating an item as basic information rather than RSI, the Board can have some bearing on the level of importance conveyed in the financial report and auditor's report. In other words, users may pay less attention to items categorized as “supplementary” in the financial report. Conversely, they may be more concerned with the auditor's conclusions regarding the fair presentation of the financial statements. Hence, the more important the item, the more likely it would be a part of the financial statements and notes prepared in conformity with GAAP, such that if the item is missing or materially misstated, the matter would be conveyed in the auditor's report on the fair presentation of the financial statements.

c. The extent to which the information interests a wide audience (rather than specialists). If an item of information is of great interest to users, the information may be a candidate for basic information. Conversely, if the item is primarily of interest to subject matter specialists, the information may accompany the basic information as RSI.

d. Extent to which there are not alternative sources of reliable information. If organizations routinely publish an item of information that is scrutinized by independent advisors, it may be more likely to be considered RSI than basic information.

e. Agreement on criteria that permit comparable and consistent reporting. If there is a lack of specific criteria for measuring an item, preparers may have great discretion in developing their calculations and auditors may lack criteria necessary for the expression of an opinion. The item of information may be a candidate for RSI.

f. Experience among users, preparers, and auditors with the information. The Board may consider the views of expert users, preparers, and auditors in developing measurement criteria for basic information. If the level of experience regarding an item is low, input on specific criteria may not be available. Also, when there is not sufficient experience to develop measurement criteria, auditors may have concerns about expressing an opinion on the information. They may express qualifications or include explanations in their report. Categorizing the information as RSI may encourage reporting while more experience is gained and criteria developed.

g. Benefit/cost ratio of using resources to compile the information as well as ensure accuracy. The Board may consider the benefit and cost associated with producing and auditing the item of information.

OAI

73F. If an item of information does not meet the criteria for basic information or RSI, it becomes a candidate for OAI. OAI is information that accompanies basic information and RSI, but is not required by a body that establishes GAAP. Some entities may desire to report information to supplement required information and enhance a user's understanding of the entity's operations or financial condition. This may include, but is not limited to, information on delivery times, turnover, and wastage of inventories; expected replacement of physical capital; and delinquency, aging, and default rates for loan portfolios. In addition, entities report information not required by a body that establishes GAAP, but required by laws or administrative directives. The laws or administrative directives may require the information to be audited and may require it to accompany basic information and RSI. However, this information is also considered OAI.

73G. Although the FASAB does not require OAI to be presented, the FASAB may at times encourage voluntary reporting of items to help in the development of information that may enhance overall federal financial reporting. For example, the FASAB may consider an item to be relevant to entity operations but, for the moment, does not meet other criteria for required information.

Table 1: Factors to Consider in Distinguishing Basic Information from RSI[2]

FACTORS TO CONSIDER IN DISTINGUISHING BASIC INFORMATION FROM RSI

Low (implies RSI)	Factor	High (implies Basic)
	<Relevance to fair presentation>	
	<Connection with elements of financial reporting>	
	<Use of various types of financial data or financial transaction data>	
	<Level of importance the Board wishes to be communicated in the financial report>	
	<Significance, relevance, or importance of the item in light of *Objectives*>	
	< Level of importance the Board wishes to be communicated in the auditor's report>	
	<Relevance to measuring financial condition or changes in financial condition>	
	<Extent to which the information interests a wide audience (rather than specialists)>	
	<Extent to which there are not alternative sources of reliable information>	
	<Agreement on criteria that permit comparable and consistent reporting>	
	<Experience among users, preparers, and auditors with the information>	
	<Benefit/cost ratio of using resources to compile the information as well as ensure accuracy>	
	<Connection with basic financial statements>	
	<Reliability and/or precision possible>	
	<Reliability and/or precision needed>	

[2] As noted in paragraph 73D, the factors are not listed in a particular order and do not represent a hierarchy of factors.

15. SFFAC 2, paragraph 74 is amended as follows.

Meeting the four objectives of Federal financial reporting in the most efficient manner suggests that reporting entities issue a financial report that would include the following:

- management's discussion and analysis;
- ~~balance sheet~~ statement of financial position (commonly referred to as balance sheet);
- statement of net costs;
- statement of changes in net position;
- statement of custodial activities, when appropriate;
- statement of budgetary resources;
- statement of financing;[footnote retained but not presented]
- statement of program performance measures; [footnote retained but not presented]
- accompanying footnotes;
- required ~~supplemental~~ supplementary information ~~pertaining to physical, human, and research and development capital and selected claims on future resources, when appropriate~~; and
- other ~~supplemental financial and management information, when appropriate~~ accompanying information.

16. SFFAC 2, footnote 14 is amended as follows.

Such components are similar to responsibility segments as referred to in ~~FASAB Exposure Draft~~ SFFAS 4, “Managerial Cost Accounting ~~for the Federal Government” (see pages 26-30)~~ Concepts and Standards, par. 78-81. Responsibility segments are used to accumulate costs and outputs for major lines of activity.

17. SFFAC 2, paragraph 76 is amended as follows.

Furthermore, there are frequently instances when one or more of the suborganizations conduct a very visible or critical activity and there is a high level of public interest, e.g., ~~Internal Revenue Service~~ tax collection activity; maintains large and complex ~~accounts with large~~ fund flows activity, ~~e.g., Defense Business Operations Fund;~~ has ~~major responsibilities for the appropriate use of~~ earmarked tax~~es~~ activity, ~~e.g., Health Care Financing Administration;~~ or its financial viability is of special concern to the Executive Branch or the Congress, e.g., deposit insurance funds. In those situations, it may be desirable for the sub-organization to prepare and issue a separate financial statement that is consistent with the concepts presented in this concepts statement. [footnote retained but not presented] In doing so, it would need to identify the parent entity and describe the sub-organization's relationship to the parent.

18. SFFAC 2, paragraph 77 is amended as follows.

The components of any reporting entity are likely to conduct transactions with other components in the reporting entity, other Federal entities, and persons and organizations outside the Federal Government. Likewise, they are likely to have assets due from and liabilities due to other Federal components and entities and to non-Federal persons and organizations. In reporting the transactions and balances of a Federal reporting entity in its entirety, it is conceptually desirable, although not always practicable, to eliminate the intra-entity transactions and balances. ~~Factors to consider are the utility of the information for the entity in its entirety if the intra-entity balances are not eliminated, the misunderstanding that might result if the balances are not eliminated, and the cost-benefit of making the eliminations.~~

19. SFFAC 2, footnote 17 (presented below) is deleted.

~~A reporting entity that eliminates none of the intra-entity transactions or balances and still desires to present the information for its individual components in separate columns could do so by preparing and issuing a combining financial statement. If the individual columns are added to a total column without elimination of the intra-entity transactions or balances, the total column would have to be labeled “Memorandum Only” to signify that it is not net of eliminations. Recognizing that the U. S. Standard General Ledger does not presently provide accounts for identifying intra-entity transactions, the decision as to when the information for a reporting entity other than the Federal Government as a whole should be presented in a consolidating financial statement rather than a combining financial statement would be specified by OMB in a Form and Content Bulletin.~~

20. SFFAC 2, paragraph 78 is amended as follows.

Some of a reporting entity's components are likely to be required by law or policy to prepare and issue financial statements in accordance with accounting standards other than ~~those recommended by~~ FASAB's ~~and issued by OMB and GAO,~~ e.g., accounting standards issued by the Financial Accounting Standards Board or accounting standards established by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards ~~recommended~~ <u>issued</u> by FASAB ~~and issued by OMB and GAO~~ should be applied. The components would need to provide any additional disclosures ~~recommended~~ <u>required</u> by FASAB and included in the OMB-issued ~~standards~~ <u>guidance</u> that would not be required by the other standards.

21. SFFAC 2, paragraph 79 is amended as follows.

In addition to budgetary integrity, operating performance, and systems and control information, r~~R~~eaders of the financial statements for the entire government are likely to be concerned primarily with whether the government has been a proper steward. This can best be achieved with the preparation and issuance of the following:

- management's discussion and analysis;
- ~~balance sheet~~ statement of financial position (commonly referred to as balance sheet);
- statement of ~~operations or~~ net costs;
- statement of operations and changes in net position;
- reconciliation of net operating revenue (or cost) and unified budget surplus (or deficit);
- statement of changes in cash balance from unified budget and other activities;
- comparison of budgeted and actual use of resources;
- statement of program performance measures;
- accompanying footnotes;
- required ~~supplemental~~ supplementary information ~~pertaining to physical, human, and research and development capital and selected claims on future resources~~; and
- other ~~supplemental financial and management information, when appropriate~~ accompanying information.

22. SFFAC 2, paragraph 81 is rescinded.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. The FASAB developed a core set of accounting standards and initial concepts statements on reporting objectives and entity and display early in its first six years of operation. Concepts were developed as initial standards were developed. In 2003, the Board began to actively review and add to or modify its concepts statements as needed. The Board's desire to evaluate its concepts after more than twelve years of successful progress is stimulated by a realization that (a) some critical concepts that have been relied on are not yet included in a concepts statement, (b) certain aspects of the concepts are not widely understood or accepted, and (c) an expansion or modification of its concepts statements will help the Board communicate more effectively with the growing community of federal financial report users, preparers, and auditors.

A2. As part of the overall project to review and expand its conceptual framework, the FASAB began deliberations on this Statement in October 2006. The FASAB noted that, in the past, it had relied on certain concepts to distinguish between basic information, RSI, and OAI. However, those concepts had not been incorporated into a concepts statement. This Statement amends SFFAC 2 to include those concepts. The Board believes that this Statement is an important part of its conceptual framework and will provide more consistent, useful, and enduring guidance to the Board.

A3. The Board focused on this Statement, in part, because of the issues that developed regarding how to communicate complex information in the most useful manner to financial report users. There are several broad financial reporting objectives each with sub-objectives that require financial and non-financial information. In addition, reporting information to achieve those objectives raises the issue of how the information should be classified. This Statement provides guidance on addressing such issues and selecting the means of communicating information necessary to help achieve the reporting objectives.

A4. The Board published the exposure draft (ED), *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information,* on March 26, 2008, with comments requested by June 26, 2008. Upon release of the ED, notices and press releases were provided to: The Federal Register, FASAB News, The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, and Government Accounting and Auditing Update, The CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council, and committees of professional associations generally commenting on EDs in the past.

A5. This broad announcement was followed by direct mailings of the exposure draft to the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate, and the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives.

A6. The Board received 19 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		3
Auditors	3	1
Preparers and financial managers	12	
Total	**15**	**4**

A7. In general, respondents agreed with the process and factors for distinguishing the categories of information. However, many respondents believed that some of the factors listed in Table 1: Factors to Consider in Distinguishing Basic Information from RSI, needed clarification. Two respondents also noted that the factors could be weighted or assigned a value because some factors seemed more important than others.

A8. The purpose of the ED is to provide conceptual guidance for developing future standards. It is intended to guide the Board in deciding issues such as what information should be a part of the financial statements prepared in conformity with GAAP (basic information) and what information should accompany financial statements prepared in conformity with GAAP (RSI). Table 1 provides a general framework for guiding members in deciding whether an item of information should be considered basic information or RSI. A general framework permits future Boards some level of flexibility in developing standards and the framework would not necessarily need to be revised as changes in the environment occurred.

A9. In addition, although some respondents suggested additional factors to consider, the Board believes that the general framework presented in the ED includes a broad range of ideas that members may consider. For example, some respondents suggested additional factors regarding the level of uncertainty involved in accounting information, such as the impact of market factors and market volatility that may affect reportable items. However, the issue of uncertainty is embodied in the existing factors, “Reliability and/or precision possible” and “Reliability and/or precision needed.”

A10. To clarify the intent of the factors presented in Table 1, the Board added brief explanations to paragraph 73E and added a footnote to the table to inform readers that, as discussed in paragraph 73D, the factors are not listed in a particular order or considered to present a hierarchy. Also, the Board removed the factor, “Extent to which the information is aggregated (lacking detail).” The Board acknowledged that members may reach different decisions when applying the factor. Also, another factor, “Benefit/cost ratio of using resources to compile the information as well as ensure accuracy,” conveys a similar idea that members may consider.

A11. Some respondents were not clear whether distinguishing between basic information and RSI was the responsibility of the FASAB or individuals. Also, one respondent noted that a factor is needed to address instances where there is a statutory or regulatory requirement to present an item as basic information, RSI, or OAI. To clarify that the FASAB determines the category of required information, the Board replaced paragraph 55 of SFFAC 2 with paragraph 8 of the Statement and modified the language in paragraph 73D by stating that the Board specifies what information should be presented as basic information and what information should be presented as RSI. The paragraph was also modified by substituting “Board member” or “Board members” for “individual” or “individuals.” In addition, when developing the ED, the Board discussed that a statutory or regulatory body may require the reporting of information beyond that required by the FASAB and may specify audit requirements for the information. Also, the information may be included in a report containing information that the FASAB requires. Paragraph 73F explains that this information is considered OAI.

A12. Regarding the OAI category, the Board noted that there may be instances where an entity may not have both basic information and RSI. For example, an entity may only have basic information to convey. In such an instance, OAI would only accompany basic information. To accommodate circumstances where an entity may not have both basic information and RSI, the Board removed the word “both” from the definition of OAI in paragraphs 5 and 73F.

A13. Some respondents suggested changes to or expressed concern regarding the reporting model, such as removing the statement of financing. Also, SFFAC 2 discusses financial statements that have not been presented in practice such as the statement of program performance measures. As part of the Board's overall conceptual framework initiative, the

Board has started a project to revisit the reporting model. The project plan includes revisiting the financial statements and other components of the reporting model presented in SFFAC 2 and respondents' views will be considered as part of that project.

A14. Respondents also expressed concern regarding the status of the required supplementary stewardship information (RSSI) category. The RSSI category was a response to the unique federal financial reporting environment and the broad financial reporting objectives. For this category, the Board intended that the Government Accountability Office and the Office of Management and Budget would define a level of auditor involvement greater than applied to required supplementary information but less than applied to basic information. However, that level has never been defined and the Board initiated projects to review and re-categorize RSSI items through a series of standards that would amend SFFAS 8, Supplementary Stewardship Reporting.

A15. Currently, the standards to re-categorize RSSI include the following: (1) SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, which eliminated the use of RSSI to report weapons systems information; (2) SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which eliminated the use of RSSI for the reporting of information about stewardship responsibilities; and (3) SFFAS 29, *Heritage Assets and Stewardship Land*, which eliminated the use of RSSI for the reporting of stewardship property, plant and equipment (PP&E). The Board plans to address the remaining RSSI item, stewardship investments, in a future standard. Once the Board reclassifies all items of RSSI, the category will be eliminated.

A16. The Board distinguishes concepts from accounting principles presented in standards. As noted earlier, the purpose of the Statement is to provide concepts to guide the FASAB in developing future standards. Thus, until the Board amends existing standards regarding RSSI, the Board expects practice to be governed by those standards.

Board Approval

A17. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB’s offices.

Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
AU	Audit Standards codified and published by the AICPA
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Concepts 7: Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording

Status

Issued	August 16, 2011
Affects	None.
Affected by	None.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.gov).

Summary

In financial reporting, measurement is the act or process of assigning dollar amounts to the elements of the financial statements (assets, liabilities, and so forth). This Concepts Statement addresses the measurement of the elements of accrual-basis financial statements of federal government entities in periods after amounts are initially recorded. It identifies and elucidates conceptual issues for the Board to consider when deliberating measurement standards in the future. It does not change existing standards.

A principal question for the Board to resolve in future standards is whether and under what circumstances it might be more useful for users' decision making to report an asset or liability in periods after its acquisition or incurrence (a) at the amount initially recorded ("initial amount"), i.e., the historical cost or historical proceeds (which may be adjusted subsequently for amortization, depreciation, or depletion, if applicable) or (b) at an amount measured at each financial statement date ("remeasured amount"), such as the fair value. This Concepts Statement discusses the advantages and disadvantages of different alternatives for measurement. However, conclusions as to which measurement approach or attribute may be selected for reporting an element under different circumstances are deferred for consideration in the standard-setting process. Standard-setting deliberations also would appropriately consider cost-benefit implications and other practical reporting concerns.

The measurement approach (initial or remeasured amounts), attributes, and methods used for measuring assets and liabilities affect how the information is reported and interpreted. The analysis in this Concepts Statement includes a comparison of the advantages and disadvantages for achieving the federal financial reporting objectives (SFFAC 1) of continuing to report an initial amount after the recognition period versus remeasuring an asset or liability at each financial statement date. Also included is a discussion of how well attributes that are commonly applied or available for measuring assets and liabilities, such as fair value and settlement amount, comply with the qualitative characteristics (SFFAC 1). The analysis suggests that, when the goal is to help ensure that reported information achieves several financial reporting objectives in response

to the various decision-making needs of a range of users, it is necessary to accept that different measurement approaches, attributes, and methods may be needed to convey useful information about different transactions and underlying events. The identification and discussion of the different measurement possibilities is expected to enhance the understanding of users and preparers as well as the Board's deliberations of future standards.

Table of Contents

Introduction

1. In financial reporting, measurement is the act or process of assigning dollar amounts to the elements of the financial statements. This Concepts Statement addresses the measurement of the elements of accrual-basis financial statements of federal government entities in periods after their initial recording. The elements are assets, liabilities, net position, revenues, and expenses, as defined in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.* Different measurements and considerations may apply for financial statements that are not presented on the accrual basis, such as a statement of budgetary resources, statement of social insurance, or statement of long-range fiscal projections, and for required supplementary information and other types of general purpose financial reporting.

Objective

2. The objective of this Statement is to identify and elucidate the conceptual issues relevant to establishing measurement standards in the future for accrual-basis financial statements.[1] A principal question for the Board to resolve in future standards is whether and under what circumstances it might be more useful for users' decision making[2] to report an asset or liability in periods after its acquisition or incurrence (a) at the amount initially recorded ("initial amount"), i.e., the historical cost or historical proceeds (which may be adjusted subsequently for amortization, depreciation, or depletion, if applicable) or (b) at an amount measured at each financial statement date ("remeasured amount"), such as the fair value. This Concepts Statement discusses the advantages and disadvantages of different alternatives for measurement. However, conclusions as to which measurement approach or attribute may be selected for reporting an element under different circumstances are deferred for consideration in the standard-setting process. Standard-setting deliberations also would appropriately consider cost–benefit implications and other practical reporting concerns.

[1] This Statement does not establish federal financial accounting standards or change existing standards.

[2] References in this Statement to usefulness for decision making encompass decisions related to accountability, management, and other needs of internal and external users, as discussed in Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting* (SFFAC 1).

Focus on Assets and Liabilities

3. The measurement concepts in this Statement focus on assets and liabilities because remeasuring elements after their initial recording is directly applicable only to assets and liabilities, insofar as the other elements are derived from them.[3] That is, balance sheets and operating statements articulate and, therefore, the measurement and recognition of changes in assets and liabilities affect reported revenues and expenses.

4. Expenses for a reporting period result from consuming assets and incurring liabilities, as well as from accounting adjustments that increase existing liabilities or decrease existing assets. Revenues result from acquiring assets and from accounting adjustments that increase existing assets or decrease existing liabilities. Consequently, expenses and revenues arise either from current-period transactions in which the resulting initial and remeasured amounts are the same (e.g., salaries expense and tax revenue), or from adjustments to existing assets and liabilities, such as for changes in the applicable discount rate (e.g., increases in pension liabilities), or for decreases in liabilities due to recognizing revenues for amounts previously reported as deferred revenues.

Financial Reporting Objectives and Qualitative Characteristics

5. The concepts in this Statement are considered with reference to the federal financial reporting objectives and the qualitative characteristics of information in financial reports.[4] The most relevant objectives to the questions discussed in this Statement are:

   a. *Budgetary Integrity*. To help the reader 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

   b. *Operating Performance.* To help the reader determine

      (1) The costs of providing specific programs and activities and the composition of, and changes in, these costs

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[3] The balance sheet element of net position is not separately addressed because it is defined as the difference between total assets and total liabilities.

[4] SFFAC 1.

(2) The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs

(3) The efficiency and effectiveness of the government's management of its assets and liabilities

c. *Stewardship.* To help the reader determine whether

(1) The government's financial position improved or deteriorated over the period

(2) Future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due

(3) Government operations have contributed to the nation's current and future well-being

6. The qualitative characteristics of information in financial reports are:

a. *Relevance*—The capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations

b. *Understandability*—The quality of information that enables users to perceive its significance

c. *Reliability*—The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent

d. *Comparability*—The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena

e. *Consistency*—Conformity from period to period with unchanging policies and procedures

f. *Timeliness*—Having information available to a decision maker before it loses its capacity to influence decisions

Concepts

Measurement Approaches and Attributes

7. The questions surrounding the measurement of assets and liabilities in accrual-basis financial statements can be grouped into two broad areas of consideration:

   a. **Measurement Approach**

   The *measurement approach* is how an asset or liability is measured in periods after initial recording—i.e., at the historical cost or initial transaction amount (with subsequent adjustments for amortization, depreciation, or depletion, if applicable) or at an amount, such as fair value, measured at each financial statement date. A different measurement approach may be appropriate for different assets and liabilities. This Statement refers to the amount initially recorded as the "initial amount" and to amounts measured at each subsequent financial statement date as "remeasured amounts."

   b. **Measurement Attribute and Method**

   The *measurement attribute* (or measurement basis)[5] is a measurable characteristic of an asset or liability, such as its fair value or settlement amount.[6] Major questions are: Which attributes result in more useful information for decision making, and what factors and circumstances may contribute to that result, such as the class of asset or liability, the type of transaction, and variations in users' decision-making needs? Also, the selection of a measurement attribute often entails the selection of a *measurement method*. For example, if the measurement approach for a particular asset is to report a remeasured amount and the measurement attribute selected is fair value, possible measurement methods could be to research quoted market prices, if available, or to obtain a professional appraisal. Different measurement attributes and methods may be used for different assets and liabilities, and the selections made can affect the usefulness of reported information for decision making.

8. The next section discusses different measurement approaches with reference to the financial reporting objectives. A later section discusses measurement attributes and methods with reference to the qualitative characteristics.

[5] Both terms are currently in use in the accounting measurement literature and convey a similar concept.

[6] These and other measurement attributes are defined and discussed in a later section.

Measurement Approaches

9. The most basic accounting and financial reporting questions relate to recognition and measurement. When should a government measure the existence of, or changes in, the value of an asset or liability? When and how should revenues and expenses resulting from these changes be measured and recognized? Should a government record changes in economic values that have occurred, even though no transaction by the government has taken place? Would the reliability of financial statements suffer if such changes were accounted for as they occur, or would the failure to account for them reduce the decision-usefulness and representational faithfulness of financial statements? Financial reporting standards traditionally have permitted or required recognition of value changes for some assets and liabilities but not for others. The issues are complicated because value changes may be due to changes in interest rates or service potential, or to different types of price changes.

Changes in Specific Prices Versus Changes in the General Price Level

10. Prices of goods and services increase or decrease for primarily two reasons:

    a. *A change in the demand for or supply of a specific product*, such as materials or equipment, which affects the market value of the product. The accounting and financial reporting question is whether these changes should be included in the balance sheet in the period in which they occur or entirely in the period when an asset or liability is disposed of or settled. For flows statements, the question is whether they should report only realized gains and losses or also the unrealized gains and losses generated by price changes before disposition of the assets or liabilities ("holding" gains and losses).

    b. *A change in the purchasing power of the monetary unit* (e.g., the dollar). That is, taking into account all goods and services bought and sold in the economy, the general price level might change such that the monetary unit buys more or less today than in a previous period. Although the number of monetary units required to buy a product might change, the relationship between the price of that product and the price of other goods or services will remain the same. For example, if the price of machine A was higher than that of machine B before the change in purchasing power, it would also be higher afterward, because the change in purchasing power would affect both prices equally. Increases (or decreases) in the number of monetary units required to purchase goods and services are referred to as inflation (or deflation).

11. Whether inflation is taken into account can affect how information is reported and interpreted. For example, assume that a federal agency acquired land for $100,000 in December 20x0 and sold it in December 20x1 for $125,000—an apparent gain of $25,000.

Suppose, however, that during the year the general level of prices increased by 15 percent. That is, goods and services that could have been purchased in December 20x0 for $1,000 would have cost $1,150 in December 20x1.[7] Thus, in the example, the land acquired for $100,000 in 20x0 dollars can be thought of as having a remeasured cost of $115,000 ($100,000 x 115/100) in 20x1 dollars. The gain on sale, expressed in *constant* dollars—in this case, 20x1 dollars—is therefore only $10,000 ($125,000 - 115,000), rather than $25,000 in *nominal* (unadjusted) dollars. The $15,000 difference between reporting the gain on sale in nominal dollars and reporting it in constant dollars is relevant to users' assessment of the stewardship and operating performance of the agency's management.

Four Possible Measurement Approaches

12. The distinction between changes in *specific prices* (or values) and changes in the *general price level* (purchasing power of the dollar) suggests four possible measurement approaches:

    a. *Initial amounts/nominal dollars*. This is the traditional measurement approach. Assets and liabilities are stated at their initial (historical cost or historical proceeds) amounts, without adjustment for changes in prices, whether general or specific.

    b. *Initial amounts/constant dollars*. Assets and liabilities are stated at their initial amounts expressed in dollars as of the balance sheet (current) date, rather than dollars of the acquisition date, so that general price level adjustments are recognized.

    c. *Remeasured amounts/nominal dollars*. Assets and liabilities are adjusted to take into account changes in the prices of specific goods or services, but no separate recognition is given to changes in the general price level.

    d. *Remeasured amounts/constant dollars*. Assets and liabilities are remeasured to take into account the current prices of goods and services—that is, adjustments are required for changes in the general price level as well as for changes in specific prices.

13. The following expansion of the earlier example compares results for the four measurement approaches. The results are illustrated in Table A.

[7] Changes in the general price level generally are stated as an index value. For example, the implicit price deflator for gross domestic product (GDP deflator), maintained by the U.S. Department of Commerce, Bureau of Economic Analysis, expresses prices of various years as percentages of prices of a selected base year, which is assigned a value of 100. If, for example, 20x0 is the base year (100) and prices in 20x1 are 15 percent higher, then the GDP deflator for 20x1 would be 115.

Example

A federal entity purchased land for $100,000 in December 20x0. The land increased in value to $125,000 by December 20x1. The entity retained the land for another year and sold it on December 31, 20x2 for $130,000. The general price level was 100 when the entity acquired the land, 115 on December 31, 20x1, and 127 on December 31, 20x2.

On December 31, 20x1, the land was worth $125,000—meaning, the entity could have realized a $25,000 nominal dollar gain by selling it. Further analysis reveals, that $15,000 of that gain resulted from general price level changes ($100,000 x 115/100) while the remaining $10,000 resulted from specific price increases. The next year, 20x2, the land reached a value of $130,000 and management sold it for a net gain of $30,000 over the two-year period.

All four measurement approaches result in a $30,000 gain being reported, but different information is available for each of the two years. Under the initial amounts/nominal dollars approach, the entire $30,000 gain is reported in 20x2. Using the initial amounts/constant dollars approach, $15,000 of the gain ($115,000 - 100,000) is reported in 20x1 and $15,000 in 20x2 ($130,000 - 115,000). Under both the remeasured amounts approaches, $25,000 of the gain ($125,000 - 100,000) is reported in 20x1 and $5,000 in 20x2 ($130,000 - 125,000). Further analysis reveals that, under both approaches reported using constant dollars, the purchasing power gain in 20x2 is $13,043 [$125,000 x (127/115) – 125,000]. Thus, under the initial amounts/constant dollars approach, the remainder of the 20x2 gain ($15,000 – 13,043 = $1,957) is attributed to a specific price increase. In contrast, under the remeasured amounts/constant dollars approach, the specific price change in 20x2 is a loss of $8,043 ($5,000 – 13,043).

Such differences can affect users' evaluation of operating performance. For example, the increase in the value of the land attributable to the 20x1 management team would be either zero or $15,000 under the initial amounts approaches versus $25,000 under the two remeasured amounts approaches.

TABLE A. Purchase and Sale of Land: Comparative Results under Four Measurement Approaches

	Measurement Approach			
	Initial Amounts/ Nominal Dollars	Initial Amounts/ Constant Dollars	Remeasured Amounts/ Nominal Dollars	Remeasured Amounts/ Constant Dollars
Acquisition cost = book value at 12/31/x0 (20x0 dollars)	$100,000	$100,000	$100,000	$100,000
Reported book value of land, 12/31/x1	100,000	115,000[1]	125,000[2]	125,000[2]
Current value of land, 12/31/x1	125,000	125,000	125,000	125,000
Reported total gain, 20x1	0	15,000[3]	25,000[4]	25,000[4]
— Purchasing power gain	0		0	
— Specific price gain	0	15,000	25,000	15,000[5]
		0		10,000
Sale price of land, 12/31/x2	130,000	130,000	130,000	130,000
Reported total gain, 20x2	30,000[6]	15,000[7]	5,000[8]	5,000[8]
— Purchasing power gain	0	13,043[9]	0	13,043[9]
— Specific price gain/(loss)	30,000	1,957	5,000	(8,043)

[1]$100,000 x 115/100 = $115,000

[2]Market value at 12/31/x1

[3]$115,000 – 100,000 = $15,000

[4]$125,000 – 100,000 = $25,000

[5]($100,000 x 115/100) – 100,000 = $15,000

[6]$130,000 – 100,000 = $30,000

[7]$130,000 – 115,000 = $15,000

[8]$130,000 – 125,000 = $5,000

[9]($125,000 x 127/115) – 125,000) = $13,043

14. Although certain federal government statistics are reported in constant dollars, there has not been a strong call to adjust the financial statements in recent decades, when inflation has been low. However, should high inflation be experienced in the future, consideration might be given to reporting financial statement information in constant dollars to assist users in assessing an entity's financial position and operating results after adjusting for inflation. If so, an examination of the advantages and disadvantages of reporting in constant dollars would be appropriate at that time.

Focus of This Statement

15. The remainder of this Statement focuses on the differences between reporting initial amounts and remeasured amounts in nominal dollars (measurement approaches a. and c. in the previous section). Under approach a., initial amounts are not adjusted for changes in either general or specific prices. Under approach c., remeasured amounts and resulting holding gains and losses incorporate the combined effects of both general and specific price changes without separately identifying them.

16. The analysis in this Statement addresses assets and liabilities in general. However, a particular financial reporting standard may permit or require the reporting of initial amounts for some assets and liabilities and remeasured amounts for others, based on the anticipated usefulness to decision makers of one approach versus the other for the reporting issues addressed in the standard.

Initial Amounts, Remeasured Amounts, and the Financial Reporting Objectives

17. This section discusses initial amounts and remeasured amounts in general and the extent to which each measurement approach helps achieve the federal financial reporting objectives. Different measurement attributes are discussed in a later section on "Measurement Attributes and Qualitative Characteristics."

Initial Amounts Versus Remeasured Amounts

18. Traditionally, the amount at which a transaction is reported has been determined in a manner appropriate to the nature of the transaction. For example, assets acquired by purchase are initially reported at the amount of the consideration surrendered by the purchaser (plus any additional costs incurred to bring the asset to a serviceable condition). Assets acquired through donation are reported at their fair value at the date of donation. Accounts receivable and payable are reported at their anticipated net settlement amounts,

which are future exit values.[8] Examples include reporting accounts receivable at net realizable value and reporting accounts payable at invoice amount less any discounts (e.g., for prompt payment). Once recorded, the amounts initially determined are often referred to as the "historical cost" of an asset or "historical proceeds" of a liability, regardless of how they were determined. In this Statement they are referred to as *initial amounts*.

19. Certain features of a transaction may make identification of an initial amount more difficult. For example, transactions may have associated costs, such as legal fees, which generally are reported as part of the initial amount. A single transaction may involve more than one asset or liability, requiring the total transaction amount to be allocated to the components. Indirect costs, such as certain labor costs, may need to be allocated to constructed assets through cost accounting procedures. Initial amounts for longer lived assets and liabilities generally are allocated to reporting periods. For example, capital assets are depreciated or amortized over their estimated useful lives. Discounts or premiums from issuance of debt are amortized or accreted over the term of the debt. Many of these features present practical questions to be resolved when setting standards.

20. Remeasured amounts of assets and liabilities are determined using one of several possible measurement attributes that reflect economic conditions at the financial statement date, including, for example, fair value or settlement amount. Remeasurement updates a previously determined carrying amount to reflect a change in the economic value of an asset or liability that has occurred since the previous financial statement date. A remeasured amount thus differs from an adjustment to an initial amount that does not reflect a change in value. For example, an increase in the accumulated depreciation balance on a building does not change the economic value of the building and does not constitute remeasurement of its carrying amount. Unless the value of the building itself is remeasured at, for example, its fair value, the reported amount will continue to be considered the initial amount. In contrast, an adjustment to an allowance for uncollectible accounts receivable due to an increased risk of noncollection constitutes remeasurement of the carrying amount, even when the gross amount of receivables is not remeasured, because the adjustment reflects a change in the economic value of the receivables—the anticipated net settlement amount.

[8]An exit value is the price or amount at which an asset could be sold or a liability extinguished. An entry value is the estimated price at which an asset which is currently on the books may be purchased. (*Kohler's Dictionary for Accountants*, sixth edition, W. W. Cooper and Yuji Ijiri, eds.; Prentice-Hall, Inc., Englewood Cliffs, N.J., 1983). Entry and exit values are referred to again in the section on measurement attributes.

Achieving the Financial Reporting Objectives

21. Assessments of which nominal-dollar measurement approach—initial amounts or remeasured amounts—better enables achievement of one or more of the financial reporting objectives vary according to the kinds of information users need and the decisions to be made.[9] In practice, federal financial statements traditionally have followed a "mixed-attribute" model. That is, some assets and liabilities, such as general property, plant, and equipment, have been reported at initial amounts (adjusted for depreciation, depletion, or amortization, if applicable), and others, such as direct loans and loan guarantees, have been reported at remeasured amounts.

22. Given the objective of reporting information that is useful for accountability and users' decision-making needs and the range of different users and information needs to be addressed, it is likely that federal financial statements will continue to include both measurement approaches as well as different measurement attributes and measurement methods under each approach. Consequently, this Concepts Statement identifies advantages and disadvantages of reporting initial amounts and remeasured amounts and of applying different measurement attributes, but no conclusions are drawn as to which measurement approach or attribute may be preferable either in general or in particular circumstances. Such conclusions are the province of the standard-setting process, in the course of which the concepts in this Statement will be considered on a project-by-project basis, along with cost–benefit considerations and other practical reporting concerns that may arise under different alternatives.

23. Continuing to report assets and liabilities at their initially recorded amounts in periods following their acquisition or incurrence is a long-established approach to financial reporting and users are accustomed to that approach. Initial amounts generally are reliable and objective, based on documented evidence, although subjectivity subsequently may be introduced through the assumptions or methods adopted for calculating depreciation or amortization, such as depreciable lives and salvage values, or, as previously indicated, through the allocation of indirect costs. Initial amounts establish a historical record of transactions that have occurred that facilitates the control and safeguarding of resources.

24. Proponents cite these advantages in support of reporting at their initial amounts the costs of inventory and capital assets and the resultant costs of providing programs and activities (referred to in the operating performance objective). These proponents believe that it is not useful to remeasure and report assets at their potential sales prices or settlement amounts when they are being held to provide services, rather than for sale. In this view, assets held to provide services should be reported at the amounts paid for them (or other initial

[9] SFFAC 1 describes the users of federal financial reporting and their decision-making needs.

amounts), and the reported cost of using them each period should be a function of that amount. With this approach, the initial amounts of assets will be allocated to service costs over the periods when the assets are used to provide services, based on the prices paid for the assets.

25. Many also support reporting initial amounts for assets used to provide services because they believe that the adequacy of taxes and other revenues should be assessed based on the amounts actually expended to acquire existing assets, rather than on the current-period costs of equivalent assets or service potential. These proponents suggest that reporting program and activity costs based on the initial amounts facilitates users' ability to assess how the use of budgetary resources relates to the costs of operations (budgetary integrity objective), whereas reporting costs each period at remeasured amounts does not. Initial amounts also may be advocated when there are significant barriers to the realization or settlement of a remeasured amount.

26. Proponents of reporting initial amounts hold that the reliability and objectivity of initial amounts is critical for users' decisions. Reporting remeasured amounts may introduce significant uncertainties and subjectivity into the information provided to users because of the extent of judgment involved in developing these estimates. Those who hold these views point out that remeasured information may reduce the reliability of financial statements. Further, they note that information that is not reliable is rarely relevant.

27. Supporters of remeasurement believe that users require up-to-date information about the price of assets held for sale or to generate future cash inflows. Further, they believe that users also need information about the costs of programs and other ongoing activities based on the current costs of the underlying assets, particularly infrastructure and other capital assets that likely were acquired many years ago. In this view, a comparison of current-period taxes and other revenues with remeasured (current) costs of the resources consumed in providing goods and services is more relevant for assessing operating performance, stewardship, and the sustainability of services than is a comparison with initial amounts that are no longer current. To provide up-to-date information on the costs of services, the underlying assets need to be reported at a remeasured amount, such as replacement cost.

28. Similarly, supporters of remeasurement believe that remeasured amounts of assets and liabilities, especially for assets acquired many years ago, are more relevant than initial amounts for assessing an entity's current financial position, service potential, and ability to meet obligations when due, as well as the magnitude of the entity's current and probable future resource needs. Over time, critical factors, such as prices and interest rates, change, yet initial amounts reflect the prices and interest rates in effect at the various transaction dates, not at the reporting date. For example, it is possible for assets acquired at different dates to be reported at different amounts, even though they have the same service

potential. Similarly, it is possible for liabilities incurred at different dates to be reported at the same initial amount, even though they do not represent equivalent economic claims on the entity's resources, because they bear different interest rates.

29. The contrasting views about the usefulness of initial amounts versus remeasured amounts suggest that an important consideration is whether the reporting objectives generally are more concerned with informing users about how efficiently and effectively budgetary resources were ultimately used to deliver goods and services, or about how all economic resources were used. The principal difference between the two goals is the treatment of the effects of price changes (unrealized or "holding" gains and losses) on reported assets and liabilities and related operating costs. The different treatments provide different information to users of the financial statements.

30. If an entity reports initial amounts, the statement of net cost reports the expiring benefits from previously expended budgetary resources only when the underlying assets are consumed or sold. The statement of net cost does not provide information about changes that occur in resource prices or the values of existing assets in the intervening periods. In contrast, if the entity reports remeasured amounts, the information reflects the capacity of the underlying assets to provide goods and services in changing circumstances. The statement of net cost captures the period-to-period changes in asset amounts (holding gains and losses) in the periods in which they occur and reports the resources consumed at current amounts, information that can help users assess stewardship and operating results each period.

31. The reporting of holding gains and losses can help fulfill the financial reporting objectives by providing information about management's performance that is useful to agency and program managers as well as to taxpayers and other users of financial reports, including, for example, the economic results of decisions to hold rather than to sell assets. This information may enhance understanding of the costs of programs and activities based on current costs, how costs are changing, the sufficiency of current resources, and future resource needs. The information also may help users assess the efficiency and effectiveness of the management of the entity's assets and liabilities, including whether a change in financial position resulted from management's operating decisions or from changes in prices beyond management's control. These kinds of information are available from the financial statements when holding gains and losses are separately displayed in the statement of net cost. Reporting initial amounts without adjustment for holding gains and losses (and excluding amortization, depreciation, and depletion) may help users compare the resources consumed for goods and services with the resources provided for those purposes. On the other hand, without information about current prices it is difficult for users to assess future resource needs and whether the entity's financial position has improved or deteriorated.

32. The expenses related to capital assets that are reported in a resource flows statement are a component of the cost of current-year services. Initial amounts may be more useful than remeasured amounts for reporting certain costs of services when the objective is to enable tracking of budgetary resources expended. For example, costs, such as amortization or depreciation of capital assets, may be viewed as the expiration of benefits derived from prior expenditures of budgetary resources. Remeasured amounts may be more useful than initial amounts for assessing operating performance when the objective is to consider the economic costs of providing specific programs and activities and to compare costs with accomplishments. Remeasured amounts also may be more useful for assessing stewardship, including whether the entity's financial position improved or deteriorated over the period, whether public services are sustainable, whether obligations can be met as they come due, and for assessing future resource needs.

33. The previous discussion suggests that there are different views and factors to be considered concerning whether the financial reporting objectives are better achieved by reporting initial amounts or remeasured amounts. Also, some individuals believe that a mixed measurement approach, whereby some assets or liabilities are reported at initial amounts and others at remeasured amounts, serves a wider range of decision-making needs than either of the two measurement approaches alone.[10] Ultimately, which measurement approach is more useful depends on the types of transactions and other events that have occurred and the information needed for the decisions to be made. Requiring the same measurement approach for all assets and/or liabilities and related costs is unlikely to be conceptually appropriate or useful for decision makers. Rather, when the goal is to help ensure that reported information meets several financial reporting objectives in response to the various decision-making needs of a range of users, it is necessary to accept that different measurement approaches, measurement attributes, and measurement methods may be appropriate to convey useful information about different transactions and underlying events.

Measurement Attributes and Qualitative Characteristics

34. The previous section evaluates two measurement approaches—reporting initial amounts and reporting remeasured amounts—in relation to the financial reporting objectives. This section examines initial and remeasured amounts in relation to the qualitative characteristics that information in financial reports should demonstrate.[11]

[10] For example, some who support reporting initial amounts for assets used to provide services also support reporting remeasured amounts for assets expected to be converted into cash.

[11] The qualitative characteristics are discussed in SFFAC 1.

35. Initial amounts are referred to in general terms because they are not changed from period to period (except for appropriate adjustments for amortization, depreciation, or depletion). Remeasured amounts are discussed with reference to the attribute measured because the attribute selected may affect the degree to which a particular qualitative characteristic is met. Also, different attributes may be selected for different assets and liabilities and, because the amounts are remeasured each period, it is possible to change the attribute, if appropriate to achieve the financial reporting objectives under changed circumstances.

36. The measurement attributes discussed are those most commonly applied or available for use: *fair value, settlement amount, replacement cost, value in use,* and *fulfillment cost*. Additional measurement attributes may be developed in the future. Fair value and settlement amount may be used to determine either the initial amount (historical cost or historical proceeds) or the remeasured amount of an asset or liability. Replacement cost and value in use (for assets) and fulfillment cost (for liabilities) are not applicable for assessing initial amounts because they are attributes of assets and liabilities that an entity already has recorded. These attributes may be used to remeasure recorded amounts at subsequent financial statement dates.

37. Different measurement methods, with varying degrees of precision, may be used in applying measurement attributes. For example, fair value may be measured by selecting a market price from applicable quotations, by estimating the present value of future resource flows, through a professional appraisal, or by applying a variety of other estimation techniques. The methods used may introduce different degrees of uncertainty in the resultant amounts and may, therefore, affect the degree to which the qualitative characteristics are met.

Fair Value

38. *Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.*

39. The fair value of an asset or liability may be measured at the market value in established markets, such as those for certain investment or debt securities, or it may be estimated when there is no active market. Estimated fair value is commonly used for the initial amounts of assets acquired through donation or other types of nonexchange transactions.

40. The fair value may be an entry (purchase) value or an exit (selling or settlement) value. For exchanges in established markets, the entry and exit values for the same item should be the same except for transaction costs and differences attributable to the value of services provided by the seller of an asset (e.g., a merchandise vendor) to the buyer.[12] When there is no established market for the exchange, differences between entry and exit prices may arise due to the use of different assumptions in arriving at an estimate of market value.

[12] For example, a PX acquires a variety of goods at a wholesale (entry value) price, provides the service of assembling the goods in a location and display that is convenient to customers, and sells them at a retail (exit value) price.

Also, when a federal entity acquires or constructs an asset for a specific public purpose, the exit value may be lower than the entry value if, for example, a potential purchaser would expect to pay a reduced price to allow for the cost of adapting the asset to an alternative use.

41. Methods used to measure fair value include calculating the present value of estimated future cash flows and estimating the fair value by reference to the current purchase or selling prices or other settlement amounts of similar assets or liabilities. A present value measurement that fully captures the economic differences among different assets and liabilities would most often include the following factors:

    a. An estimate of the future cash flow, or in more complex cases, series of future cash flows at different times

    b. Expectations about possible variations in the amount or timing of those cash flows

    c. The time value of money, represented by the risk-free rate of interest

    d. The price for bearing the uncertainty inherent in the asset or liability

    e. Other, sometimes unidentifiable, factors including illiquidity and market imperfections.[13]

42. When fair value is used to measure and report an initial transaction, the amount becomes the historical cost or historical proceeds of the resultant asset or liability. The relevance, reliability, understandability, and comparability across entities of the reported amount are high in the initial reporting period, but they may decline with each successive period when compared with remeasured amounts. When market values can be used, amounts that are remeasured at fair value generally are high in relevance, reliability, and understandability, and in their comparability to equivalent amounts reported by other entities and their contribution to timely reporting. When fair values must be estimated, the degree to which the qualitative characteristics are met may vary depending on the availability of information about similar assets and liabilities and the degree of estimation required.

Settlement Amount

43. *Settlement amount is the amount at which an asset can be realized or a liability can be liquidated.*

[13] Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, February 2000, par. 23.

44. Settlement amounts are exit values that are based on transactions and may be adjusted by the reporting entity for expectations regarding circumstances that may influence future settlement. When used to report receivables, the settlement amount is often referred to as the net realizable value. For example, the settlement amount or net realizable value for a receivable would be the invoiced amount adjusted for expectations regarding credit losses. For accounts payable, the settlement amount is the amount that the creditor will accept in settlement of its claim for compensation for goods or services provided. For long-term liabilities, the settlement amount is often calculated by applying net present value techniques to expected future cash flows. For example, the settlement amount for loan guarantees may be measured by projecting defaults, and subsequent recoveries, on guaranteed loans and applying an entity-specific discount rate to the resultant cash flows. The resultant measure represents the amount of cash that would need to be invested at the stated interest rate (i.e., the discount rate) to provide cash flows equal to the expected future cash payments required to settle the guaranteed loans. In contrast to fair value, the settlement amount would not take into account the price that the market would charge for bearing the risk or uncertainty associated with the asset or liability.

45. When used for initially recording and reporting short-term assets and liabilities, the degree of relevance, reliability, and understandability of settlement amounts could be similar to that afforded by fair values. However, the relevance of initial amounts for longer term assets and liabilities would decline in subsequent periods. Remeasured settlement amounts would seem to be more appropriate because their relevance and reliability would be maintained or enhanced as the reporting dates approached the final settlement date. For some long-term liabilities, remeasurement may require the professional expertise of disciplines such as, for example, that of actuaries with respect to pension liabilities.

Replacement Cost

46. *Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life.*

47. Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the

fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

48. The relevance of replacement cost is high, especially for assessments of financial position and future resource needs. The level of understandability, reliability, and comparability across entities of reported replacement cost amounts may vary according to the data used and the complexity of the calculation.

49. Reporting the replacement cost of capital assets used in providing services and related service costs can facilitate comparisons between program and activity costs and accomplishments related to the same period. An objection sometimes raised is that replacement cost is not an attribute of the asset that is actually owned. However, the asset being measured is not the physical asset but the services it can provide.

Value in Use

50. *Value in use is the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life.*

51. Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service. Examples include inventory and equipment with a unique design and purpose, and special-purpose buildings, such as prisons. In those cases, the value in use may be greater than the amount the entity could obtain from selling the asset because the selling price would need to accommodate the purchaser's need to adapt the asset to another purpose.

52. The service potential of an asset may be difficult to assess when the asset is used in combination with other assets and the total assessment must be allocated to the individual assets. In those cases, the reliability, consistency, and understandability of the remeasured amounts may be lower than when a direct assessment can be made of the value in use of each asset. The relevance of value in use is high for assessments of an individual entity, both with regard to the entity's management and for users' evaluations of operating performance, especially the entity's efficiency and effectiveness in managing its assets. However, the entity-specific nature of value in use reduces inter-entity comparability.

Fulfillment Cost

53. *Fulfillment cost includes all costs that an entity will incur in fulfilling the promises that constitute a liability.*

54. Fulfillment cost is a remeasured, entity-specific amount. It is an exit value that includes payments to the counterparty and other costs that arise from fulfilling the promises that constitute a liability assumed by an entity, such as for environmental remediation. The fulfillment cost differs from the settlement amount. The settlement amount is based on a transaction with an external party, potentially adjusted by the entity for circumstances that may affect the payment amount. The fulfillment cost, in contrast, is the value to the entity of the resources that will be used in liquidating the entity's assumed liability and is not necessarily equal to the carrying amount or the fair value of those resources. Thus, the fulfillment cost of an entity's liability is analogous to the value in use of an entity's asset.

55. When the fulfillment cost depends on uncertain future events, possible alternative outcomes need to be considered when developing the estimated cost to reduce the potential for bias in the assessment. When fulfillment requires work to be done—for example, when the liability is for environmental remediation—the relevant costs are those that the entity will incur for either doing the work itself or employing a contractor. The fulfillment costs of long-term liabilities would be discounted to the reporting date, adjusting for risk at the risk-free rate, if appropriate.

56. Fulfillment costs are relevant to assessments of an entity's financial position but, because they are entity specific, they may not be comparable for assessments of other entities. Their reliability and understandability may vary depending on the complexities and uncertainties reflected in their measurement.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by members in reaching the conclusions in this Concepts Statement. It includes the Board's reasons for accepting certain proposals and rejecting others. Some factors were given greater weight than other factors. The concepts enunciated in this Concepts Statement—not the material in this appendix—should guide the resolution of measurement issues that affect specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background

A1. Early in its operations, the FASAB developed a core set of accounting standards and initial statements of federal financial accounting concepts (SFFACs or concepts statements) on reporting objectives and entity and display. Concepts were developed as initial standards were developed. In 2003, the Board decided that it should review and add to or modify its concepts statements as needed. In addition to the initial SFFACs, the Board has issued concepts statements on management's discussion and analysis; the consolidated financial report of the U.S. government; the definition of elements and basic recognition criteria for accrual-basis financial statements; and distinguishing among basic information, required supplementary information, and other accompanying information. This Concepts Statement further expands the Board's conceptual framework.

A2. SFFAC 1, *Objectives of Federal Financial Reporting* (September 1993), defined the users and objectives of federal financial reporting, as well as the qualitative characteristics of reported financial information. SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* (December 2007) identified and defined the elements of accrual-basis financial statements and established basic criteria for recognizing them. This Concepts Statement builds on the concepts established in SFFACs 1 and 5 by discussing different alternatives for measuring assets and liabilities (and, by extension, revenues and expenses) and the extent to which the alternatives meet the objectives and qualitative characteristics established in SFFAC 1.

A3. FASAB has established requirements for measuring certain assets, liabilities, revenues and expenses through federal financial reporting standards without the benefit of an underlying, cohesive framework of measurement concepts. Such a framework can provide significant guidance to the current and successor Boards when establishing financial reporting standards in the future. As a result, the consistency, understandability, and usefulness of reported information to decision makers, including preparers and users of financial information, should be enhanced. Consistent with the role of the Board's conceptual framework, this Concepts Statement does not change current financial reporting standards or establish new standards.

Statement Objectives and Content

A4. This Concepts Statement identifies and elucidates conceptual issues for the Board to consider when deliberating measurement standards in the future. A principal question for the Board to resolve in future standards is whether and under what circumstances it might be more useful for users' decision making to report an asset or liability in periods after its acquisition or incurrence at the amount initially recorded ("initial amount") or at an amount measured at each financial statement date ("remeasured amount"). The measurement approach (initial or remeasured amounts), measurement attributes, and measurement methods used for measuring assets and liabilities affect how the information is reported and interpreted.

A5. The analysis in this Concepts Statement includes a comparison of the advantages and disadvantages for achieving the federal financial reporting objectives of different measurement approaches and attributes. The analysis suggests that, when the goal is to help ensure that reported information achieves several financial reporting objectives, different measurement approaches, attributes, and methods may be needed to convey decision-useful information about different transactions and underlying events.

A6. The Board considered whether it should indicate that some of the measurement alternatives discussed in this Concepts Statement are preferred to others in certain specified circumstances. The Board concluded, however, that to indicate preferences would effectively result in establishing financial reporting standards in a concepts statement. The Board reasoned that decisions concerning whether certain measurement alternatives are preferred should be made in the context of deliberations on specific financial reporting standards. That context will enable the Board to focus on the specific reporting issues to be addressed and to consider the benefit vs. the cost of different measurement alternatives and other practical concerns, as well as the conceptual guidance provided by this statement.

A7. In developing this Concepts Statement, the Board benefited from research conducted in similar projects on measurement concepts under development by the Governmental Accounting Standards Board (GASB), the International Public Sector Accounting Standards Board, and the Financial Accounting Standards Board in collaboration with the International

Accounting Standards Board. The FASAB met several times in joint session with the GASB on matters of mutual interest in their respective measurement concepts projects.

Outreach, Responses, and Board Conclusions

A8. An Exposure Draft (ED) of this Concepts Statement was issued September 13, 2010, with a comment deadline of November 30, 2010. The issuance was announced in the *Federal Register*, *FASAB News*, the *Journal of Accountancy*, and *AGA Today*. Listserv notices announced the ED and periodically reminded subscribers about the comment deadline. Notices were sent directly to organizations responding to past EDs. In addition, the ED was included in updates provided to liaison groups, such as the Financial Statement Audit Network.

A9. The Board received a total of 16 responses from these sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**	**TOTAL**
Users, academics, others		3	3
Auditors	3	1	4
Preparers and financial managers	9		9
Totals	12	4	16

A10. A large majority of the respondents supported the ED and the measurement concepts proposed by the Board, including the measurement approaches, attributes, and methods. Very few concerns were expressed. A few respondents' comments appeared to be based on an assumption that the Board was proposing new measurement standards. The Board may consider those comments when it deliberates future measurement standards. However, the purpose of this Concepts Statement is to establish measurement concepts to guide the standard-setting process in the future.

A11. No concerns were raised by a majority of the respondents. However, the Board does not rely on the number in favor of or opposed to a given position. The Board considered the arguments in each response and weighed the merits of the points raised. The following points were raised by a minority of the respondents and the Board reached the conclusions indicated.

a. *The Concepts Statement should discuss cost–benefit issues* (four respondents). As discussed in paragraph 22, the Board concluded that the cost–benefit of different measurement alternatives should be addressed in deliberations on specific measurement standards.

b. *The ED refers to the selection of an initial amount or a remeasured amount for reporting as the "principal question," but the ED does not answer the question* (two respondents). The Board reaffirmed that it did not intend to establish preferred measurement approaches or attributes, which would be addressed in the standard-setting process. The Board revised certain wording in the Executive Summary and in paragraph 2 of this Statement to avoid potential misunderstandings.

c. *The list of measurement attributes should include "going-concern"—"the value of the entity as a whole"* (one respondent). The Board reaffirmed that the goal of this Concepts Statement is to present concepts that the Board should consider when setting standards that include requirements for measuring the elements of the financial statements. Consistent with that goal, a measurement attribute is defined in paragraph 7b as "a measurable characteristic of an asset or liability, such as its fair value or settlement amount." The Board concluded that "going-concern" is not an attribute of an individual asset or liability. Rather, it is a concept that applies to the entity as a whole. Moreover, financial reporting standards do not address the direct measurement of the current value of entities as a whole. When setting standards, a going-concern is assumed.

d. *Delete the attributes "replacement cost" and "fulfillment cost" because they "are not intended to reflect the current value or historical cost of an asset or liability"* (one respondent)*. Delete "value in use" because of its "inherent subjective nature"* (one respondent). *Delete "fair value," "replacement cost," "value in use," and "fulfillment cost" because they do not meet the needs of the respondent's agency* (one respondent). The Board reaffirmed that the purpose of this Concepts Statement is to present measurement concepts that the Board will consider when establishing future financial reporting standards. The Board concluded that this Concepts Statement should be comprehensive in terms of available measurement attributes, even though the Board may decide when setting financial reporting standards that certain attributes may not be appropriate for a particular measurement standard or for certain agencies' activities.

e. *Provide examples of how the attributes are used currently* (one respondent). Some of the measurement attributes are not currently used in the federal reporting environment. The Board agreed, however, that more descriptive information about the attributes would be useful. The Board has added language in the discussion of attributes (paragraphs 38–56) to clarify how certain attributes could provide useful information.

f. *Provide a comparative chart or table to illustrate the pros and cons of different measurement alternatives, including, for example, preferred alternatives under various* *circumstances or pros and cons for different accounting line items* (two respondents). As discussed in paragraph A6, the Board concluded that to indicate preferences for particular alternatives would effectively result in establishing financial reporting standards in a concepts statement. In this Concepts Statement, the Board has provided a balanced discussion of the different measurement approaches and attributes, leaving decisions on which approach and attribute may be preferred for particular classes of assets or liabilities or for specific types of transactions to be made when setting standards.

A12. In deliberating the final Concepts Statement, the Board concluded that the attribute "settlement amount" could be usefully applied for reporting non-financial as well as financial assets and liabilities. As a result, the definition of this attribute (paragraph 43) was reworded to: "Settlement amount is the amount at which an asset can be realized or a liability can be liquidated." The Board also added language to the discussion of settlement amount and fulfillment cost to clarify the differences among settlement amount, fair value, and fulfillment cost.

Board Approval

A13. This Concepts Statement was approved for issuance by all members of the Board.

Statement of Federal Financial Accounting Concepts 8: Federal Financial Reporting

Status

Issued	September 22, 2017
Affects	None.
Affected by	None.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.gov).

Summary

This concepts statement discusses the role of financial statements[1] and required supplementary information (RSI) and their relationship to other reported financial and non-financial information. This Statement also discusses 1) the content and presentation of financial statements and RSI for government-wide and component reporting entities, 2) the presentation of budgetary information in component reporting entity financial statements and RSI, 3) the presentation of performance information in financial statements and RSI, and 4) the summary-level information relating to financial statements and RSI.

[1]Disclosures are an integral part of financial statements.

Table of Contents

Introduction

Purpose

1. This Statement provides a platform to address current and evolving reporting needs and capabilities and discusses concepts to assist the Federal Accounting Standards Advisory Board (FASAB or "the Board") in developing standards for improving the reporting models for the government-wide and component reporting entities.

2. In developing this Statement, the Board considered concepts that are most important to addressing users' needs. As a result, some existing FASAB concepts such as those discussed in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, are reemphasized to clarify users' needs. In addition, this Statement discusses principles the Board considered when developing the existing models and that the Board considered important for achieving the reporting objectives. The concepts and principles also explain the relationship between information required by generally accepted accounting principles (GAAP)[2] and other reported financial and non-financial information (ORFNI). Hereinafter, information required by GAAP will be referred to as financial statements[3] and required supplementary information (RSI).[4]

3. This Statement also assists preparers and users in understanding the purposes of financial statements and RSI and how this information relates to ORFNI.

4. This Statement enhances the Board's conceptual framework regarding

   a. the relationship between financial statements and RSI and ORFNI contributing to the financial reporting objectives,

   b. the content and presentation of financial statements and RSI for government-wide and component reporting entities,

   c. the presentation of budgetary information in component reporting entity financial statements and RSI,

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[2]The American Institute of Certified Public Accountants designated FASAB as the source of GAAP for federal reporting entities.

[3]Disclosures are an integral part of financial statements.

[4]Management's Discussion and Analysis is a component of RSI.

d. the presentation of performance information in financial statements and RSI, and

e. the summary-level information relating to financial statements and RSI.

5. The enhancements to the conceptual framework address users' need to better understand the variety of information available and its relationship to financial statements and RSI. Since FASAB developed its earlier concepts statements, the range of data and information available to the public has evolved. This information includes reports that comprise financial statements and RSI, budgetary information, non-financial performance information, and information on systems and control.

6. Moreover, the enhancements address users' need to better understand 1) the relationships among budget, cost, and performance information for federal programs and services, 2) the government's financial condition, 3) component reporting entity budgetary information, and 4) the relationship between the government-wide and component reporting entities' financial statements and RSI.

Scope

7. As intended, the overall financial reporting objectives discussed in SFFAC 1 are broad. They reflect the diverse needs of federal financial information users and are designed to improve the quality (for example, relevance and consistency) of data available in a wide variety of reports.

8. This Statement clarifies SFFAC 1 by emphasizing the objectives most relevant for financial statements and RSI and, therefore, most important for the development of standards.

9. This Statement focuses primarily on concepts to support achieving the Operating Performance and Stewardship objectives. It also provides concepts for reporting budgetary information. The concepts will guide the development of standards for the government-wide and component reporting entity financial statements and RSI.

10. The Board develops GAAP for reporting on the financial results of operations, financial position, financial condition, and operating performance of the federal government and its component reporting entities, including the status of budgetary resources provided to component reporting entities. These basic items are complemented by a variety of financial measures and ORFNI. Financial statements and RSI that include information on budgetary activity and results will provide a more comprehensive and insightful understanding of the government's financial position, results of operations, financial condition, and operating performance than budgetary and financial information individually. Financial statements and

RSI are part of a larger body of information available to users; this concepts statement discusses how financial statements and RSI relate to and complement this larger body of information.

11. The Board is charged with considering "the budgetary information needs of executive agencies and the needs of users of federal financial information"[5] and is committed to supporting efforts to ensure the accuracy and reliability of reporting on the budget. While budgetary and financial accounting information are presented on different bases of accounting, the information is, in effect, about different aspects of the same transactions. Thus, information is provided to assist users in understanding those aspects and their relationship.

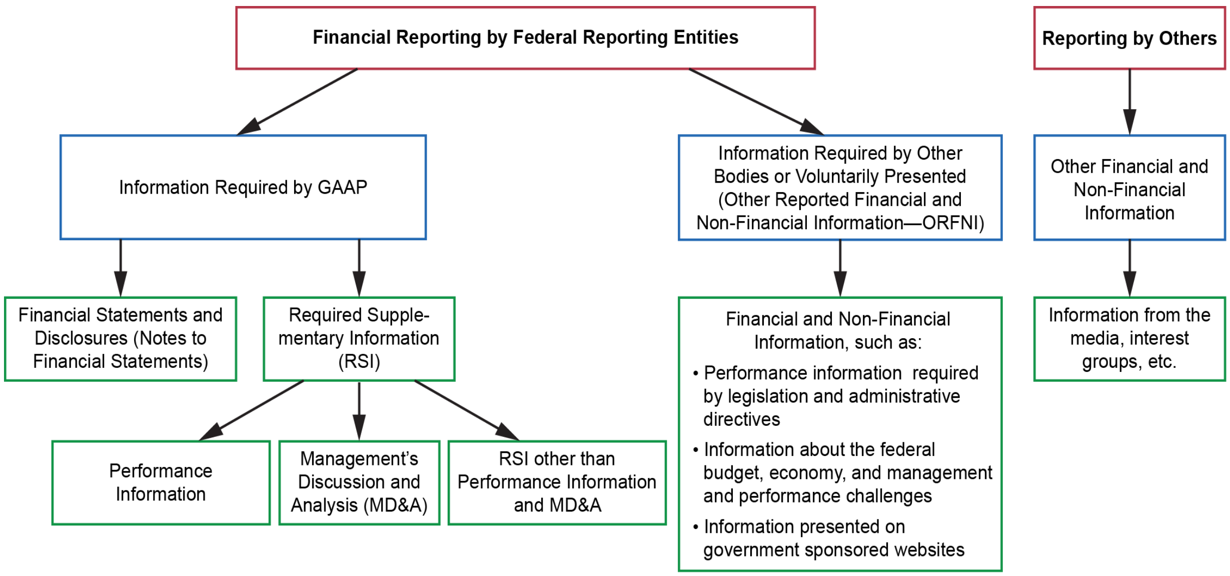
12. This Statement discusses the types of information presented to meet various user needs. Figure 1: Information for Assessing Accountability and for Decision Making illustrates the relationship between financial statements and RSI and the larger body of information available to users for assessing the government and its components' accountability and for decision making.

13. The figure shows that information for assessing the government's accountability and for decision making includes financial reporting by federal reporting entities and reporting by others. This Statement focuses on financial reporting by federal reporting entities, which includes information required by GAAP and information required by others or reported voluntarily - ORFNI. Information required by GAAP consists of financial statements and RSI. ORFNI consists of financial and non-financial information such as performance information and information on the federal budget and the economy. This information is presented at the discretion of management or to satisfy other reporting requirements. Reporting by others includes other financial and non-financial information presented by the media, interest groups, or other non-federal reporting entities.

14. Figure 1 provides examples of the types of information that may be presented and is not intended to represent current or future financial reporting requirements. In addition, while each of the types of information presented in the figure may be condensed and presented as summary-level information, paragraphs 67 to 74 of this Statement discuss summary-level information with respect to financial statements and RSI.

[5]FASAB "Memorandum of Understanding," (October 2009), 2.

Figure 1: Information for Assessing Accountability and for Decisions



Concepts

Federal Financial Reporting Objectives

15. While users of federal financial information need information similar to that of private sector financial information users, they also need additional types of information. Private sector entities primarily obtain their resources through voluntary transactions with individuals or other organizations. However, the federal government primarily obtains its resources from the involuntary payment of taxes and borrowing. Users of federal financial information are concerned about matters such as

    a. the sources of resources,

    b. how the government used the resources it obtained,

    c. what services the public received from the resources provided,

    d. whether the resources provided were sufficient to cover the cost of services provided,

    e. whether the government's financial ability to provide services improved or deteriorated, and

    f. whether the services provided contributed to the accomplishment of the intended purposes.

16. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, provides additional discussion on the types of users of federal financial information, their financial information needs, and the objectives of reporting financial information. There are four overall reporting objectives that form the foundation for all other concepts:

    a. Budgetary Integrity. 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.

    b. Operating Performance. 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.

c. Stewardship. 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.

d. Systems and Control. Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

i. transactions are executed in accordance with budgetary and financial laws and other requirements,

ii. transactions are consistent with the purposes authorized,

iii. transactions are recorded in accordance with federal accounting standards,

iv. assets are properly safeguarded to deter fraud, waste, and abuse, and

v. performance measurement information is adequately supported.

17. The report released by the Federal Accounting Standards Advisory Board (FASAB or "the Board"), titled *Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting,* affirmed these objectives and clarified that the Board's primary focus should be on the Operating Performance and Stewardship objectives. With respect to the Stewardship objective, the Board's focus is on the government's financial condition rather than the nation's financial condition.

18. SFFAC 2, *Entity and Display,* identifies the financial information needed to meet the objectives. It also recognizes some of the identified information that should be presented in financial statements and required supplementary information (RSI).

Financial Statements and RSI

19. To achieve the reporting objectives, federal reporting entities may present financial statements, RSI, and other reported financial and non-financial information (ORFNI). To establish a platform for discussing the relationship between financial statements and RSI and ORFNI, this section discusses the role of financial statements, generally accepted accounting principles (GAAP) and principles relevant to financial statements, and the role of RSI.

20. Financial statements and RSI are two means of providing information collectively intended to assist users of federal financial information in assessing the financial results of operations, financial position, financial condition, and operating performance of the federal government and its component reporting entities, including the status of budgetary resources provided to component reporting entities.

21. Users of federal financial information need a variety of information to assess the government's finances. However, the degree to which individual items meet certain qualitative characteristics may vary. Thus, as discussed in SFFAC 6, *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*, different means may be used to communicate this information and each is subjected to different audit procedures and reporting requirements under generally accepted government auditing standards (GAGAS). SFFAC 6 defines basic information as "information that is essential for financial statements and notes to be presented in conformity with [GAAP]" and RSI as "information that a body that establishes GAAP requires to accompany basic information."[6]

22. GAAP provides criteria for categorizing, recognizing, measuring, and depicting the government's financial activities in financial statements. In addition, GAAP

    a. is based on a common understanding of terms and elements, as well as the relationships among them;

    b. ensures financial statements and RSI meet certain qualitative characteristics;[7] and

    c. guides the preparation and exchange of information.

23. The Board develops GAAP for reporting on the financial results of operations and financial position of the government-wide and component reporting entities and to provide budgetary information to assist in monitoring the receipt and use of resources. Preparing financial statements that provide information on financial results of operations, financial position, and budgetary information necessitates different bases of accounting. For example, the accrual basis of accounting recognizes revenue when earned and recognizes costs when incurred to achieve an objective, such as providing or acquiring services. Reported budgetary information in the government-wide reporting entity uses primarily cash-based budgetary accounting to recognize budget receipts when cash is received and budget outlays when cash is disbursed. Budgetary accounting in component reporting entities recognizes events when the component reporting entity receives appropriations and when it enters into an

[6]SFFAC 6, par. 4.

[7]SFFAC 1, par. 156-164 discuss the qualitative characteristics of information in financial reports.

agreement that obligates the government to make payments in the future, such as when it awards a contract.

24. Although a variety of projections may be used in preparing financial statements, long-term projections may be used to inform users on the sustainability of services. Long-term projections depict the results that may occur provided current policy regarding receipts and spending is maintained.

25. RSI accompanies financial statements and may include

    a. performance information to help users evaluate the service efforts, costs, and accomplishments of the entity;

    b. management's discussion and analysis (MD&A) to communicate management's insights about the reporting entity, increase users' understanding of the information presented and the usefulness of the information, and provide information about the entity's operations, service levels, successes, challenges, and future;[8]

    c. and other information regarding the entity.

According to SFFAC 2, RSI "may be experimental in nature to permit the communication of information that is relevant and important to the reporting objectives while more experience is gained through resolution of accounting issues."[9]

26. Financial statements and RSI include explanations to assist users in understanding the differences among the bases of accounting, the information provided, and the use of projections.

27. Financial statements and RSI may include narrative and graphic depictions to explain the relationships among items of information.

[8]See SFFAC 3, *Management's Discussion and Analysis*, for concepts regarding MD&A.

[9]SFFAC 2, par. 73C.

Other Reported Financial and Non-Financial Information and Its Relationship to Financial Statements and RSI

28. This section discusses the characteristics of ORFNI and its relationship to financial statements and RSI.

29. The government-wide and component reporting entities may present information that is not required by GAAP. These entities may present this information to help achieve the reporting objectives or comply with laws and administrative directives. Hereinafter this information will be referred to as *ORFNI*.

30. There may be limitations to ORFNI. For instance, ORFNI

    a. may lack exposure to the same level of internal controls as financial statements and RSI,

    b. may lack consistency with GAAP standards for financial statements and RSI,

    c. may not meet the qualitative characteristics of financial statements and RSI, and/or

    d. may not be subject to certain procedures required by GAGAS.

31. Multiple methods of presentation may help facilitate user needs. For example, financial statements, RSI, and ORFNI may be presented in a hierarchical structure that permits users to review both highly aggregated data and disaggregated data. The different levels of data help provide users with the information at levels of specificity relevant to their particular needs. For example, users may drill-down from the government-wide reporting entity's financial statements to ORFNI in schedules provided by a component reporting entity.

32. Narrative descriptions or visual representations may enhance users' understanding of the financial statements, RSI, and ORFNI and direct them to additional information.

33. Financial statements and RSI provide information to assist users in assessing topics, such as the entity's financial results of operations, financial position, financial condition, and operating performance. While financial statements and RSI focus on the widespread needs of different users, ORFNI may be required by administrative directives or presented voluntarily to meet the specific needs of a user or user group. For example, a component reporting entity may present information to address a specific congressional concern.

34. ORFNI can also contribute to achieving the objectives of federal financial reporting. For instance, information on the risks that stem from major natural disasters or implicit guarantees assist users in assessing the government-wide reporting entity's financial condition. In addition, to comply with directives regarding performance reporting, component reporting entities may present information on how their activities benefit public health, safety, and welfare, their progress on achieving strategic objectives, or their actions to improve performance. ORFNI may also include information about the federal budget, the nation's economy, management and performance challenges, or financial information presented on government-sponsored websites.

Concepts for Government-Wide and Component Reporting Entities

35. This section includes a discussion on 1) the types of information the government-wide reporting entity financial statements and RSI provide, 2) the types of information component reporting entity financial statements and RSI collectively provide, and 3) the relationship between the government-wide and component reporting entities.

The Government-wide Reporting Entity

36. The federal government is responsible for the nation's defense and general welfare and is a single economic entity made up of component reporting entities that provide services to individuals and organizations.

37. The federal government has unique capabilities to finance the services provided and accomplish its objectives. It has the power to levy taxes, charge fees, and borrow.

38. The federal government can borrow money to finance services when expenditures exceed receipts during a period.

39. Given the operations of the government-wide reporting entity, financial statements and RSI collectively provide information to assist users in understanding

    a. the government's mission, organization, and relationship to component reporting entities;

    b. the government's performance;

    c. the government's sources and uses of resources and financial results for the period;

d. the provisions in the tax code that reduce tax revenue;[10]

e. the government's assets, liabilities, and net position as of the end of the reporting period (financial position);

f. the long-term impact of the government's policies on debt held by the public;

g. the government's budget surplus or deficit for the period, including how the surplus or deficit relates to the government's net financial results and change in monetary assets during the period;

h. the government's investments in productivity and economic growth during the period (stewardship investments);

i. the relationship between the information presented in each financial statement and RSI;

j. the changes in amounts and types of elements presented in financial statements;

k. the future effects of existing, currently known demands, risks, uncertainties, events, conditions and trends; and

l. the possible future effects of anticipated future demands, events, conditions, trends, risks assumed, etc., management believes would be important to users.

40. SFFAC 1, specifically paragraphs 134 to 145 and paragraphs 180 to 182, discusses users' need for information regarding the government's financial position and financial condition and the relationship between the two concepts. Information on the government's financial position is the starting point for assessing the government's financial condition. SFFAC 1, paragraph 144, states the following:

> Financial condition is a broader and more forward-looking concept than that of financial position. Reporting on financial condition requires financial and nonfinancial information about the national economy and society, as well as about the government itself…

[10] For example, to encourage home ownership and stimulate residential construction, the federal government may enact tax provisions that reduce the tax liability for taxpayers who incur the costs associated with mortgage interest and local property taxes. These provisions are referred to as tax expenditures.

Assisting users in understanding the government's financial condition requires multiple indicators,[11] including information regarding the changes in the government's financial position, the long-term impact of the government's policies on debt held by the public, and the sustainability of public services as discussed in SFFAC 1, paragraphs 140 to 142. Information on the government's financial position and financial condition is needed to assist users in assessing matters such as whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits and the long-term sustainability of government policies.

COMPONENT REPORTING ENTITIES

41. Component reporting entities receive budget authority through appropriations made in the legislative process. Their missions and reporting requirements are established in various laws enacted over time, resulting in a complex network of operations and services. Component reporting entities across the federal government are diverse and the scope and nature of each component reporting entity's activities can be diverse and at times overlap.

42. In light of the reporting objectives of component reporting entities, financial statements and RSI collectively provide information to assist users in understanding

    a. the entity's mission, structure, goals, and objectives, including the relationships among the component reporting entity, other component reporting entities, and the government-wide reporting entity;

    b. the entity's performance in achieving its goals and objectives;

    c. the entity's sources and uses of resources and financial results for the period;

    d. the entity's assets, liabilities, and net position as of the end of the reporting date (financial position);

    e. the status of the entity's budgetary resources;

    f. the investments in productivity and economic growth during the period, consistent with the mission of the component reporting entity;

    g. the relationship between the information presented in each financial statement and RSI;

[11] SFFAC 1, footnote 14.

h. the changes in amounts and types of elements presented in financial statements;

i. the future effects of existing, currently known demands, risks, uncertainties, events, conditions and trends; and

j. the possible future effects of anticipated future demands, events, conditions, trends, etc., management believes would be important to users.

43. The Operating Performance objective of federal financial reporting states, in part, that users need information to help them evaluate the entity's costs and accomplishments and how those costs and accomplishments have been financed.[12]

44. Often, the accomplishment of component reporting entity goals, programs, and objectives is dependent on the delivery of services granted or contracted to state and local governments and for-profit and nonprofit organizations. Users of those component reporting entity financial statements may be interested in the percentage of the component reporting entity budget authority allocated to these entities and how the component reporting entity measures the delivery of those services.

45. Aggregating and categorizing information by strategic goal is one means of providing information on the entity's costs and accomplishments and its manner of financing. Presenting such information in this manner assists users in understanding the entity's progress in achieving its strategic goals.

46. The Operating Performance objective also states users need information about

a. the costs of providing specific programs and activities and the composition of and changes in these costs;[13]

b. the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and[14]

c. the efficiency and effectiveness of the government's management of its assets and liabilities.[15]

47. Information about a component reporting entity's financial position is important for achieving the Operating Performance objective and providing information on the entity's assets and

[12]SFFAC 1, par. 122.

[13]SFFAC 1, par. 126.

[14]SFFAC 1, par. 128.

[15]SFFAC 1, par. 128.

liabilities. Because most component reporting entities are not independent economic entities and budget authority from Congress specifies the amount, purpose, and duration of their funding, readers should be referred to the government-wide reporting entity's financial statements for information about the financial position of the federal government. Such information is important for achieving the Stewardship objective. The Stewardship objective states users need information about whether

a. the government's financial position improved or deteriorated over the period,

b. future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and

c. government operations have contributed to the nation's current and future well-being.

The government-wide reporting entity can tax and borrow funds while most component reporting entities do not possess such authority.

48. For component reporting entities that receive budget authority on an annual basis, users need to know 1) the budgetary activity during the period, 2) the extent to which budget authority has been used and remains available, and 3) whether additional funding may be needed. Information is needed on the amount of the entity's appropriations that have not been expended at the end of the period, the amount the entity has accumulated from prior period funding, and the amount of liabilities for which the entity has incurred but not received budget authority.

49. Users need information to assess the financial condition of component reporting entities that derive their funding primarily from sources other than through annual appropriations. Some component reporting entities may be delegated authority to carry on their activities similarly to private-sector businesses or maintain their operations and meet their liabilities from revenues received from sources outside of the government-wide reporting entity. Citizens rely on the services provided and are concerned about their sustainability.

Concepts for Budgetary Information Presented In Component Reporting Entity Financial Statements and RSI

50. Users need information about the budgetary resources provided to finance component reporting entity activities. The Budgetary Integrity objective states that federal financial reporting should assist the federal government in fulfilling its duty to be accountable for monies raised from the public and their use. Information about the amount of budgetary resources made available, the amount of budgetary resources used, and the amount that remains available assists users in monitoring the authority provided, its use, and whether resources remain available.

51. The budget process is the government's principal mechanism for Congress and the president to reach agreement on goals, allocate resources among competing needs, and assess the government's fiscal effect on economic stability and growth. While most attention is paid to the future-oriented roles of the budget process, budget execution is designed to monitor monies raised through taxes and other means and ensure that those monies are used according to the requirements provided in law.

52. In developing budget legislation, Congress decides on targets for spending and receipts, the deficit or surplus, and the limit on debt. Upon determining the targets, Congress provides component reporting entities with budget authority and may pass laws affecting receipts and other spending.[16]

53. Budget authority provided in appropriation acts is generally considered discretionary spending. Appropriations provide component reporting entities with the authority to incur obligations for specific purposes, amounts, and time periods. An appropriation can be limited to a single year or multiple years, or it can be available indefinitely.

54. Budget authority provided in laws other than appropriation acts, is generally considered mandatory spending.

55. Budget authority comprises the following capacities:

    a. Appropriations—Provided in appropriation acts, authorizing laws, or other legislation, appropriations permit agencies to incur obligations and make payments.

    b. Borrowing Authority—Usually provided in laws other than appropriation acts, borrowing authority permits agencies to incur obligations but requires them to borrow funds, usually from the general fund of the Treasury to make payments.

    c. Contract Authority—Usually provided in laws other than appropriation acts, contract authority permits agencies to incur obligations in anticipation of the collection of receipts that can be used for payments.

    d. Spending Authority from Offsetting Collections—Usually provided in laws other than appropriation acts, spending authority from offsetting collections permits agencies to credit offsetting collections to an expenditure account, incur obligations, and make payment using the offsetting collections.[17] Offsetting collections are deducted from gross spending or gross outlays to reflect the government's net transactions. They may

[16]Analytical Perspectives, *Budget of the U.S. Government*, Fiscal Year 2016, p. 92.

[17]Analytical Perspectives, *Budget of the U.S. Government*, Fiscal Year 2016, pp.101-102.

result from business-like transactions with the public or intragovernmental transactions.[18]

56. When component reporting entities engage in transactions that require either an immediate or future outlay of cash, they incur an obligation using available budget authority. The use of budget authority reduces the component reporting entity's budgetary resources and the subsequent outlay of cash reduces the government-wide reporting entity's assets. For example, when a component reporting entity awards a contract, it uses budget authority and the government-wide reporting entity's cash is later reduced when disbursed to the contractor.

57. Budget authority is not always used in a single year. For example, budget authority enacted for the construction of a capital asset may include the estimated total cost for the project at the time the project begins. However, the component reporting entity may use that budget authority over several years and the outlay of cash may relate to budget authority provided in previous years as well as the current year.

58. Budgetary resources include new budget authority (including direct spending authority and obligation limitations) and unobligated balances of budget authority from prior years.[19]

Performance Results

59. Financial statements and RSI provide information to assist users in assessing the 1) amount of financial and non-financial resources required to provide services (efforts), 2) accomplishments of services, 3) efficiency and effectiveness of providing services, and 4) changes in the performance of services over time.

60. Users are concerned about the government's progress in accomplishing its goals. The reporting objectives consider these concerns and state "financial reporting should provide information that helps the reader to determine … the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs[.]"[20]

61. SFFAC 1, paragraphs192 to 210, provides concepts for considering how financial statements and RSI might contribute to reporting on performance results. The concepts

[18]Analytical Perspectives, *Budget of the U.S. Government*, Fiscal Year 2016, pp. 99-100.

[19]Government Accountability Office, *A Glossary of Terms Used in the Federal Budget Process* GAO-05-734SP (Washington, D.C.: Sept. 1, 2005).

[20] SFFAC 1, par. 14.

discuss the categories of performance measures that help address the financial reporting objectives—measures of efforts and accomplishments and measures that relate efforts to accomplishments (efficiency and effectiveness measures).

62. SFFAC 1 also states cost is a component of efforts, efficiency, and effectiveness measures, and measuring cost is a function of accounting and the financial reporting system.[21]

63. SFFAC 3, *Management's Discussion and Analysis*, notes performance information is an integral part of financial reporting,[22] and paragraphs 42-49 of SFFAC 3 discuss concepts for presenting performance information as RSI. Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*, paragraphs 41 through 66, discusses the role of managerial cost accounting in financial reporting, including the following language:

    Measuring and reporting actual performance against established goals is essential to assess governmental accountability. Cost information is necessary in establishing strategic goals, measuring service efforts and accomplishments, and relating efforts to accomplishments.[23]

64. Financial statements and RSI also provide explanatory information to help users understand reported measures and the factors that may have affected the reported performance. SFFAC 1, paragraphs 211 and 212, discuss the limitations of performance measurement. For example, measures of efforts and accomplishments may not indicate why performance is at the reported level. Therefore, financial statements and RSI also provide explanatory information to help users understand performance measures and the factors that may have affected the reported performance.

Summary-Level Information

65. For reports to be understandable to different audiences, different reports may be necessary to provide information relevant to the needs of the expected report users, with suitable amounts of detail, explanation, and related narrative.[24]

[21] SFFAC 1, par. 193.

[22] SFFAC 3, par. 13.

[23] SFFAS 4, par. 58..

[24] SFFAC 1, par.159

66. Information in financial statements and RSI may be condensed and provided as a presentation of summary-level information.

67. Presenting layers of information may be useful for communicating needed information. Different levels help users locate the detail they may need for their specific analysis. The top level may provide highly aggregated information while lower levels provide increasingly more detailed information. However, all lower level information need not be presented in the report itself. Lower level information may be either electronically linked or provided in other reports, with information on how to obtain such reports provided.

68. The highly aggregated top level, or summary level, may be most useful to citizens and is likely the level where they will begin their review. Citizens need a succinct but comprehensive picture of the reporting entity's activities. They may not have extensive knowledge of accounting and budgeting concepts to fully understand disaggregated financial and non-financial information and the relationship among different items. Accordingly, understandability is an important characteristic of summary-level information.

69. With respect to data, citizens may rely on visual representations rather than tabular presentations and extensive narratives.

70. To help inform users of the reporting entity's finances, information at the summary level assists users in assessing

    a. the purpose or the intent of the summary level, informing users of the type of information they might expect to see and the relationship to the government-wide and/or component reporting entity, as appropriate;

    b. the scope of the summary level, so users understand the information the level includes;

    c. basic performance goals and measures;

    d. sources and uses of resources and financial results;

    e. assets, liabilities, and net financial position as of the end of the reporting period;

    f. the status of budgetary resources;

    g. challenges facing the entity;

    h. financial condition to include sustainability information; and

    i. trends.

71. Financial information presented in relation to performance goals and measures may assist users in understanding the summary-level information presented.

72. A graphic presentation of other levels, including their relationships or links, may assist users in identifying and accessing sources for additional information.

Appendix A: Basis for Conclusions

This appendix discusses some 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 concepts enunciated in this Statement–not the material in this appendix–should guide the development of standards for specific transactions, events, or conditions.

Project History

A1. This project is part of the Board's conceptual framework initiative. After several years of progress in federal financial reporting, FASAB decided to revisit its conceptual framework with a focus on ensuring accounting standards are based on a sound and comprehensive framework of objectives and concepts. The conceptual framework project began in 2006. At that time, Board members were concerned the reporting objectives were broad, and some members sought to better define the role of GAAP-based financial statements in achieving them. Also, some preparers were concerned about the need for certain financial statements, such as the component reporting entity balance sheet. Accordingly, the Board began the conceptual framework initiative by revisiting the reporting objectives. The Board affirmed the original reporting objectives and subsequently completed concepts defining elements, identifying measurement attributes, and distinguishing between basic information and RSI. The Board also began engaging the federal reporting community in discussions regarding the government-wide and component reporting entity reporting models.

User Needs and Reporting Community Outreach

A2. In 2006, FASAB staff conducted a series of roundtable discussions to determine whether the objectives remained valid and appropriate and to help define the role of the Board in achieving these objectives. Roundtable participants provided their views on whether the objectives continued to reflect the information needs of users and whether these objectives were being achieved. The participants believed the reporting objectives remained valid, and they noted the objectives could be accomplished by reports and similar materials other than financial statements. Consequently, in November 2006, the Board agreed to retain the broad objectives and issued its report titled *Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting*. The report discusses the Board's primary and secondary focuses relative to the reporting objectives.

A3. After completing SFFAC 6, the Board began discussing the need for conceptual guidance that describes the reporting model and how it relates to the reporting objectives. The concepts would guide the Board in determining the financial statements that contribute to the achievement of the reporting objectives and help focus on "what should be" versus "what is." The former would help achieve the objectives and ensure the statements are useful to readers. Members also questioned whether a relationship should exist among financial statements, such as the balance sheet and a statement of net cost, and how the model compares with the reporting models of other governments. As a result, staff (1) researched the diverse needs of users and how they access information; (2) surveyed other countries and their reporting models; and (3) conducted discussions with preparers, citizen intermediaries, Congressional staff, program managers, executives, auditors, state and local government planners and analysts, and experts in federal financial reporting.

A4. Meanwhile, the Board continued its deliberations on social insurance and long-term sustainability reporting, projects that would significantly affect the existing reporting model and raise conceptual questions that should be addressed in the conceptual framework initiative. Board members discussed conceptual issues such as the purpose of the balance sheet and its elements. Eventually, the Board developed the conceptual framework needed to better explain unique governmental accounting issues, such as why

a. the power to tax is not an asset but nonetheless is relevant to assessing the sustainability or the financial condition of the federal government,

b. deficits have short- and long-term implications,

c. the timing of cash flows is important, and

d. the point estimates on the balance sheet have limitations for assessing financial condition.

A5. Accordingly, the Board decided to consider these and other reporting concepts in the reporting model project.

A6. FASAB staff provided the Board with a series of reports and discussion papers. In summary, staff noted users needed information regarding

a. the cost of programs,

b. the performance of programs,

c. the sustainability of programs, and

d. how actual spending compared to the budget.

A7. Also, users needed plain language, understandable information, as well as the ability to access additional information and prepare their own reports.

Task Forces and Additional Research

A8. The Board organized the reporting model task force to consider the user needs and reporting community survey results and provide suggestions for the reporting model to the Board. In December 2010, the task force completed its work and presented recommendations to enhance the reporting model. In general, the task force focused on what could be accomplished in the near future. The team also focused on the Financial Report of the U.S. Government (FR) because the public would likely start with the FR to learn about the fiscal health of the federal government. Consequently, the task force recommended (1) the adoption of a centralized, web-based method of reporting financial and performance information, (2) changes to particular financial statements, and (3) additional disclosures. Task force members believed the success of these recommendations required raising public awareness of federal financial reporting.

A9. In February 2011, the Board discussed the task force recommendations. Members discussed systems constraints and challenges and noted many of the recommendations could be adopted voluntarily by preparers. However, Board members did note the conceptual framework to guide accounting standards remained incomplete and out of date. The Board, at this time, also discussed its priorities and plans and revisited its *Strategic Directions* report. The Board reaffirmed its conclusions in the *Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting* report and noted factors that would likely influence federal financial reporting. Those factors included the notion that citizens and citizen intermediaries are the primary audience for the FR, which implies FASAB standards should focus on the FR and should primarily consider citizens' information needs. Additionally, the Board confirmed component reporting entity reports should support the needs of the FR.

A10. Later in 2011, the Board discussed the report, *The Chief Financial Officers Act of 1990 – 20 Years Later*: *Report to the Congress and the Comptroller General* (*CFO Act Report*). The report recommended Congress consider directing FASAB, the Office of Management and Budget (OMB), and the Government Accountability Office to evolve the financial reporting model. Consequently, the Board reviewed the reporting model of component reporting entities and conducted discussions with CFOs and various groups to determine the information of value to users.

A11. Given the range of issues identified during the discussions with CFOs and various groups, the Board decided the project should be segmented into three separate projects—improving cost, improving performance, and improving budgetary reporting. FASAB organized task forces for each project. This approach allowed members to better focus on issues that needed to be addressed.

A12. In 2012, the three task forces proceeded to discuss these issues and subsequently recommended the Board revisit SFFAS 4. The task forces believed adequate cost guidance was necessary to support users of budget and performance information and provide cost information that met expectations. Upon reviewing the task force recommendations, the Board determined the project would involve matters outside of the Board's domain and would require coordination with the Department of the Treasury and OMB. Also, members again raised concerns about systems constraints and challenges in presenting integrated cost, budget, and performance information.

A13. Subsequently, the Board engaged with the National Academy of Public Administration (NAPA) to learn more about the needs of executives and managers. Members also learned about preparers' needs for resources to guide financial information development. The research informed the Board on (1) the availability of financial and related information, (2) the effective use of financial data by senior managers, (3) the current and desired role of the CFO, and (4) the options most likely helpful in closing those gaps between the current and desired role of the CFO. The NAPA team conducted interviews with federal executives and senior managers with operating responsibility for agencies, bureaus, offices, divisions, or comparable organizational units.

A14. NAPA's report, *Financial and Related Information for Decision-Making: Enhancing Management Information to Support Operational Effectiveness and Priority Goals*, discussed the following topics:

a. Data generally are highly accurate and granular, but federal agencies face challenges in analyzing and transforming data into readily understood, actionable information for executive decision making—especially the linking of budget, costs, and performance.

b. The degree to which financial data are effectively used for decision making is heavily driven by each organization's revenue source (user fee-based versus appropriation-based) and operational approach.

c. CFO organizations will increasingly need to offer valuable decision-making support to executives and senior managers, including sophisticated cost and performance analysis.

Developing Ideal Reporting Models without Constraints

A15. At this point, Board members noted they needed models of the ideal presentation to serve as the end-goal for the project and help guide their direction. Also, given that raising concerns about existing systems and challenges directed the discussions away from "what should be," the Board determined development of ideal models would not be constrained by considering existing systems and what the Board could accomplish immediately. In addition, the models would take a holistic view and consider the other conceptual issues discussed previously and include explanations on why the resulting construct should be considered ideal. Consequently, the Board decided to develop conceptual, ideal models that integrate budget, cost, and service performance information.

Flow Information: The Starting Point for Developing Ideal Models

A16. During the April 2014 meeting, FASAB members presented their views of ideal reporting models. The presentations addressed the Budgetary Integrity objective generally and each of the sub-objectives of the Operating Performance objective. Also, with respect to the Stewardship objective, the Board decided to focus on the federal government as the entity rather than the nation's economy. In addition, in June of 2014, the Board decided not to revisit the reporting objectives or clarify the role of FASAB with respect to the objectives. Instead, the Board began developing the ideal reporting model by focusing on the flows and the flow statements that would help achieve the reporting objectives.

A17. Based on feedback from the reporting community, users still needed to better understand flow information, such as cost and budgetary information and how they relate. The Board considered how cost and budgetary information should be disaggregated and addressed how to reconcile cost and budget at a level that would be clear to users.

A18. However, members expressed concern about whether the concepts should include illustrations of financial statements and whether concepts should reflect an "aspirational" reporting model or simply describe current practice. Consequently, the Board developed an inventory of concepts and topics that might be included in the concepts statement. Upon completing the inventory, the Board would deliberate which items should be retained in the concepts statement.

Inventory of Concepts and Framework for an Exposure Draft

A19. In February 2015, the Board began developing an inventory of concepts that would help guide development of the reporting models and in December 2015 decided on a framework or outline to guide development of an exposure draft (ED) concepts statement. The Board agreed the framework needed to be comprehensive and include new and existing concepts and topics members had suggested during the project.

A20. Subsequently, staff began using the framework to develop the ED. The Board determined the guidance should focus on information required by GAAP—financial statements and RSI—rather than information presented in a general purpose federal financial report (GPFFR).

GPFFRs are broader and refer to financial statements, RSI, and ORFNI. The Board determined the concepts should discuss the purposes of financial statements and RSI and ORFNI to assist users in understanding their relationships.

A21. The Board also determined the concepts should discuss component reporting entity budgetary information, performance results information, and summary level information. Throughout the project, the Board discussed the need to clarify the role of financial statements and RSI with respect to budgetary and performance information. The Board considered that both budgetary and performance information include data derived from financial systems and transactions affected by GAAP. Including concepts on budgetary and performance information would assist the Board in contributing to the reporting objectives and requiring information that helps users understand the relationships among budget, cost, and performance information.

A22. Regarding summary level information, the Board considered citizens' feedback and concluded that citizens are more likely to understand a summary-level presentation of financial and non-financial information than a detailed presentation. Concepts would assist the Board in determining the guidance that might be needed for summary-level information.

Summary of Outreach Efforts and Responses

A23. The Board issued the ED, *Federal Financial Reporting*, on September 29, 2016 and requested comments by January 6, 2017.

A24. Upon release of the ED, the Board provided notices to the following organizations:

a. The *Federal Register*

b. *FASAB News*

c. The *Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, and the CPA Letter*

d. The CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network

e. Committees of professional associations generally commenting on exposure drafts in the past

A25. The Board followed this broad announcement with direct mailings to the following:

a. House Committee on Oversight and Government Reform, Subcommittee on Government Operations

b. House Transportation Committee, Subcommittee on Economic Development

c. House Committee on the Budget

d. Senate Committee on Homeland Security and Government Affairs and the following subcommittees:

   i. Subcommittee on Federal Spending Oversight and Emergency Management

   ii. Subcommittee on Regulatory Affairs and Federal Management

e. Senate Committee on the Budget

f. Senate Committee on the Environment and Public Works

g. Senator Patty Murray, ranking member of the Senate Subcommittee on Labor, Health and Human Services, and Education, member of the Senate Committee on the Budget, and member of the Senate Committee on Veterans' Affairs.

h. Senator Tom Carper, ranking member of the Senate Committee on Homeland Security and Governmental Affairs, member of the Senate Committee on Environment and Public Works, and member of the Senate Committee on Finance

i. CPA Caucus

A26. The Board received 16 comment letters from preparers, auditors, professional associations, and citizens. The respondents generally agreed with the broad concepts proposed and provided comments and suggestions that the Board may consider when it deliberates future financial reporting standards.

A27. The Board considered each response, weighing the merits of the points raised and made revisions to the ED to clarify the intent of the concepts. Some respondent comments and resulting actions are summarized below.

Other Reported Financial and Non-Financial Information (ORFNI) and Types of Reports, Electronic Reporting, and Public Access to Government Data

A28. Some respondents provided comments regarding ORFNI and how it might be enhanced with discussions on (1) types of ORFNI, (2) the role of transactional information or information provided through implementation of laws such as the Digital Accountability and Transparency Act of 2014 (DATA Act), (3) electronic reporting and its relationship to financial statements and RSI, and (4) the relationship between ORFNI and component reporting entity annual financial reports.

A29. To afford the flexibility needed to address future financial reporting issues, the Board determined the concepts should be broad. The requirements specified in laws and OMB circulars are subject to change and the contents of specific reports, websites, and other means of providing access to financial information are subject to change as well. In addition, some reporting intended for general audiences may include information required by GAAP while other reporting may not. Explicit discussion of existing practices may cause the Board to revise the Statement each time changes occur. While these comments may be helpful for future standard setting, no adjustments were made to the concepts statement.

Required Supplementary Stewardship Information (RSSI), Management's Discussion and Analysis (MD&A), Financial Statements, Required Supplementary Information (RSI), and Other Accompanying Information (OAI)

A30. Some respondents suggested providing guidance distinguishing the categories of information, such as financial statements, RSI, and MD&A. Others suggested providing guidance regarding Required Supplementary Stewardship Information (RSSI). Another respondent suggested clarifying the concepts used to distinguish when projections might be used in financial statements and when projections might be considered RSI. In addition, a respondent suggested eliminating the separate categories of RSI, RSSI, and other accompanying information (OAI). Although helpful for future standard setting, no adjustments were made to the concepts statement.

A31. SFFAC 6 discusses the distinction among the categories of information and permits the Board discretion in deciding which category should be used for an item of information. FASAB's standards specify what items should be in a category. For instance, while SFFAC 3 discusses concepts for information in MD&A, SFFAS 15, *Management's Discussion and Analysis*, requires MD&A items as RSI.

A32. SFFAS 8, *Supplementary Stewardship Reporting*, requires items to be presented in RSSI. An elimination of the RSSI category would be accomplished through standards rather than concepts. The Board expects existing practice to continue until members have examined and deliberated on the issue and, if warranted, amends SFFAS 8.

Component Reporting Entity Financial Position

A33. Respondents discussed the importance of information about a component reporting entity's financial position. The Board revised paragraph 50 of the ED to emphasize that component reporting entities are not independent economic entities but their financing is distinct from the government-wide reporting entity's financing.

Board Approval

A34. This statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

Appendix B: Abbreviations

CFO	Chief Financial Officer
ED	Exposure Draft
FR	Financial Report of the U.S. Government
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
NAPA	National Academy of Public Administration
OAI	Other Accompanying Information
OMB	Office of Management and Budget
ORFNI	Other Reported Financial and Non-Financial Information
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Concepts 9: Materiality: Amending Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting, And SFFAC 3, Management's Discussion and Analysis

Status

Issued	May 4, 2020
Affects	• SFFAC 1, amends paragraph 164 and inserts a chapter titled Materiality between the current chapters 6 and 7. • SFFAC 3, amends paragraph 26 footnote 10.
Affected by	None.

See pages 6-7 for the preamble to Statements of Federal Financial Accounting Concepts (www.fasab.gov/pdffiles/handbook_preamble.gov).

Summary

This concepts statement updates concepts related to the application of materiality in the federal financial reporting environment. Through amendments to SFFAC 1, Objectives of Federal Financial Reporting, and SFFAC 3, Management's Discussion and Analysis, this SFFAC clarifies implementation of materiality concepts in the issuance of federal financial statements.

A reporting entity considers materiality in the application of specific requirements to information contained in its general purpose federal financial reports. This Statement clarifies the materiality guidance. It identifies the users, scope, and factors to consider when applying materiality in the federal environment. This Statement will also enhance preparers' and auditors' understanding of materiality concepts in federal financial reporting.

Table of Contents

Concepts

Amendments to SFFAC 1, Objectives of Federal Financial Reporting

This paragraph *amends Statement of Federal Financial Accounting Concepts (Statement or SFFAC) 1, Objectives of Federal Financial Reporting, by inserting a chapter titled Materiality between the current chapter 6: Qualitative Characteristics of Information in Financial Reports and chapter 7*: *How Accounting Supports Federal Financial Reporting.* The new *Materiality* chapter is as follows:[1]

164a. A reporting entity considers materiality in the application of accounting and reporting requirements. The Federal Accounting Standards Advisory Board (FASAB or "the Board") intends that information presented in accordance with generally accepted accounting principles (GAAP)[12.1] will not contain misstatements, including omissions of information, considered material. Such omissions include information that is necessary for a reasonable financial report user (reasonable user)[12.2] to understand the effect of particular material transactions, events, and conditions on the entity's financial statements, notes to the financial statements, and required supplementary information. Footnote (FN) [12.1] Such information would include financial statements, notes to the financial statements, and required supplementary information.[2]

FN 12.2. A reasonable financial report user has appropriate knowledge of the federal government's activities and reviews and analyzes the information diligently.

FN 12.2. A reasonable financial report user has appropriate knowledge of the federal government's activities and reviews and analyzes the information diligently.

164b. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information.

[1] The inserted chapter will become chapter 7: Materiality and the existing chapters following chapter 6 in SFFAC 1 will be renumbered to accommodate the insertion.

[2] Statement of Federal Financial Accounting Standards 57, Omnibus Amendments 2019, eliminates required supplementary stewardship information (RSSI) in the general purpose federal financial report.

164c. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

164d. Misstatements should be considered individually and in the aggregate. Materiality determinations regarding such misstatements should include consideration of both qualitative and quantitative factors. Information that is not considered quantitatively material may be considered qualitatively material if it can reasonably be expected to change or influence the judgment of a reasonable user. Qualitative considerations include the public accountability[12.3] of the reporting entity; applicable legal and regulatory requirements; the visibility and sensitivity of government programs, activities, and functions; as well as other factors that may affect a reasonable user's judgment about the information.

FN 12.3. SFFAC 1, par. 73 and 74 identify different kinds of accountability. These may be relevant qualitative considerations in determining materiality.

164e. Materiality concepts and related factors should be considered when making materiality judgments. While specific qualitative and quantitative thresholds for materiality are not provided in this Statement, illustrative factors are discussed in paragraphs 164c and 164d.

164f. In applying materiality concepts, the specific needs of a reasonable user should be considered. In the federal government environment, such needs generally differ from those of the commercial entity financial report user. For example, due to the visibility and sensitivity of government programs, the needs of federal government financial report users extend to having the ability to assess the allocation and use of resources in the federal government. Compliance with laws, regulations, contracts, and grant agreements is also a significant consideration of the user.12.4

FN 12.4 Information requiring protection from unauthorized disclosure is referred to as "classified national security information." The application of federal financial accounting standards needs to support the legal requirements to protect classified national security information.

164g. To emphasize that materiality should be considered in applying the accounting standards, the Board will place the following notice at the end of each Statement of Federal Financial Accounting Standards (SFFAS):

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. FN

FN: Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

Amendment to SFFAC 3, Management's Discussion and Analysis

This paragraph amends SFFAC 3, Management's Discussion and Analysis, footnote 10 at paragraph 26 as follows:

FN 10 Materiality of effects to be discussed should be evaluated in the context of the ~~specific~~ reporting entity, ~~not the Government as a whole.~~

Appendix A: Basis for Conclusions

This appendix discusses some 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 concepts enunciated in this Statement-not the material in this appendix-should guide the development of standards for specific transactions, events, or conditions.

Project History

A1. The Board added the note disclosures project to its agenda in October 2017 with the objective of improving the relevance, clarity, consistency, and comparability of disclosures among federal entities. Staff formed a task force to assist the Board with the related research. The Board also conducted a survey on disclosures in which a majority of respondents indicated that materiality-based judgment can assist in eliminating redundant and unnecessary disclosures by providing only relevant information.

A2. Currently, materiality concepts are discussed in three Statements: SFFAC 3; SFFAS 1, *Accounting for Selected Assets and Liabilities*; and SFFAS 3, *Accounting for Inventory and Related Property*. The Board concluded that the clarity, detail, and organization of that guidance could be improved. As such, the Board agreed to update the materiality guidance to assist preparers' and auditors' understanding of the Board's intention with respect to making materiality judgments and improving disclosures.

A3. In February 2018, staff provided draft materiality concepts to the note disclosures task force. The task force included federal financial report preparers, auditors, and consultants. Task force members agreed the draft was not significantly different from their understanding of the application of materiality in practice, but it would help in applying materiality concepts in the federal environment by providing more clear, detailed, and organized guidance.

Materiality Concepts

A4. This Statement does not include substantive changes to underlying materiality concepts. Rather, to provide better guidance, this Statement clarifies the materiality concepts by discussing the needs of reasonable users, clarifying the concept of misstatement, and identifying specific federal environment considerations. This Statement is also intended to enhance preparers' and auditors' understanding of the materiality concepts in federal financial reporting.

A5. In developing this Statement, several sources were considered, including the materiality discussion in the current *FASAB Handbook*, other accounting standards boards' publications, relevant audit standards, and Securities and Exchange Commission (SEC) guidance.

A6. The Board considered the guidance in the Government Accountability Office (GAO)'s *Government Auditing Standards* (GAS)[3] when assessing the materiality concepts for the federal environment. Similar to what is stated in GAS section 6.03 and noted in paragraph 164f, the needs of the federal government report user generally differ from those of the commercial entity financial report user. The Board considered the users identified in SFFAC 1 (citizens, Congress, federal executives, and federal program managers) in developing this *Materiality* Statement. In addition, paragraph164f also highlights some important elements related to the visibility and sensitivity of government programs.

A7. This Statement clarifies that materiality should be assessed using both quantitative and qualitative considerations. Quantitative considerations (for example, magnitude of the misstatement), without considering the nature of the misstatement and the circumstances in which the judgment about it has to be made, generally do not provide a sufficient basis for a materiality judgment. Thus, misstatements should also be assessed using qualitative considerations to determine if those qualitative considerations can reasonably be expected to change or influence the judgment of a reasonable user.

A8. The SEC Staff Accounting Bulletin Topic 1.M.1 states, "Even though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading."[4] The Board has a similar view. Misstatements should be considered individually and in the aggregate.

A9. Financial statements presented fairly in accordance with GAAP could contain misstatements as long as those misstatements are not material. Additionally, the Board concluded materiality-based judgment in federal financial reporting can assist in eliminating redundant and unnecessary disclosures.

A10. This Statement defines materiality in terms of the likelihood that a misstatement, including the omission of information, could reasonably be expected to affect the judgment of a reasonable user relying on the information. The Board ultimately concluded that "could

[3] GAO, *Government Auditing Standards 2018 Revision*, GAO-18-568G (Washington, D.C.: July 17, 2018), 109-110.

[4] "Codification of Staff Accounting Bulletins, Topic 1: Financial Statements," Securities and Exchange Commission, accessed April 30, 2020, https://www.sec.gov/interps/account/sabcodet1.htm#M.

reasonably be expected" conveyed the appropriate level of certainty to use in determining whether a misstatement would affect the judgment of a reasonable user. The Board noted that the meaning of "can reasonably be expected" in paragraph 33 of SFFAS 5, *Accounting for Liabilities of the Federal Government*, may be ambiguous. SFFAS 5, paragraph 33 states, "'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 Board concluded that "can reasonably be expected" or "is believed" represent alternatives, both qualifying "to be more likely than not" and is not intended to equate "reasonably be expected" with "more likely than not."

A11. When developing the materiality definition in paragraph 164b, the Board considered the terms "probable" and "more likely than not," currently used in existing FASAB pronouncements, as alternatives to "could reasonably be expected." The Board noted that the inconsistencies throughout FASAB guidance in the meaning of "probable" may cause confusion. The Board also concluded that "more likely than not" (more than a 50 percent chance of occurrence) is not appropriate in assessing the overall application of materiality because it conveys a lower degree of likelihood compared to "can reasonably be expected." Therefore, the Board concluded that both "probable" and "more likely than not" were not appropriate to be used in the materiality definition.

A12. Prior to the exposure of the proposed materiality concepts, the Board also discussed whether to use "substantial likelihood" or "could reasonably be expected" in its materiality definition. The Board noted that "substantial likelihood" had not been previously used by FASAB and would require a specific definition that could inhibit the preparer's judgment when applying materiality.

A13. Because of the public accountability of government entities, various legal and regulatory requirements, and the visibility and sensitivity of government programs, the materiality thresholds in federal practice may be different from those in the commercial practice. Each standards-setter sets its standards for the unique characteristics of its constituency. The Board concluded that, for purposes of this Statement, "could reasonably be expected" is based on whether a reasonable person would expect that a misstatement would affect the judgment of a reasonable user, and, therefore, "could reasonably be expected" allows appropriate flexibility and judgment in considering the specific facts, circumstances, size, and nature of the misstatement when assessing whether a misstatement is material. It also accommodates the distinguishing characteristics of the federal environment. Ultimately, the Board proposed "could reasonably be expected" in its exposure draft (ED) and received positive feedback on it from the respondents.

A14. In arriving at the materiality definition in paragraph 164b, the Board also observed that materiality definitions vary among other standards-setters' current and proposed guidance. Some of the materiality definitions include:

a. The International Accounting Standards Board (IASB) uses "*could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make.*"[5] [Emphasis added]

b. The Financial Accounting Standards Board (FASB) uses "*probable that the judgment of a reasonable person relying upon the report would have been changed or influenced.*"[6] [Emphasis added]

c. The Public Company Accounting Oversight Board (PCAOB) uses substantial likelihood in the following context: "…there are certain accounts or disclosures for which there is *a substantial likelihood that misstatements of lesser amounts than the materiality level established for the financial statements as a whole would influence the judgment of a reasonable investor.*"[7] [Emphasis added]

d. In addition, the Audit Standards Board (ASB) currently uses, "Misstatements, including omissions, are considered to be material if, individually or in the aggregate, they *could reasonably be expected to influence economic decisions of users that are taken based on the financial statements*." The ASB has proposed to use, "Misstatements, including omissions, are considered to be material if there is *a substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements*."[8] [Emphasis added]

A15. The Board recognizes the differences in terms used by different standards-setters to define materiality. The Board also recognizes the possibility that the definitions of materiality may be applied differently by preparers and auditors. The Board considered the merits of convergence with the audit literature but concluded that aligning the materiality definitions was not essential because materiality in terms of financial statement reporting is different from the financial statement audit perspective.

A16. The Board does not provide specific quantitative or qualitative considerations in this Statement. Both quantitative and qualitative considerations are typically entity specific. Other existing literature already provides detailed guidance on materiality considerations. Materiality considerations could vary depending on whether the reporting entity is a sub-component, component, or the government-wide reporting entity.

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[5] IASB, *Definition of Material (Amendments to IAS 1 and IAS 8)*, October 2018.

[6] FASB, Concepts Statement No. 8 *Qualitative Characteristics of Useful Financial Information*, August 2018.

[7] PCAOB, Auditing Standard No.11 *Consideration of Materiality in Planning and Performing an Audit*, August 2010.

[8] In June 2019, the ASB issued an exposure draft of a proposed Statement on Auditing Standards, *Amendments to the Description of the Concept of Materiality*.

A17. In certain situations, an entity may have a quantitatively significant balance or activity that would lead to a quantitatively high entity-wide materiality threshold. If applied to the entity's other balances or activities, such elevated materiality amounts could influence a reasonable user's judgment regarding the rest of the entity's activities. In such cases, qualitative factors should be considered to determine whether separate materiality considerations are warranted. Materiality may vary by financial statement, line item, or group of line items within that entity.

Summary of Outreach Efforts and Responses

A18. The Board issued the ED on October 15, 2018, with comments originally requested by January 23, 2019. In light of the partial government shutdown during the comment period, some departments and agencies may not have been able to respond by the deadline; therefore, FASAB extended the comment deadline to March 11, 2019.

A19. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the *Federal Register*, FASAB News, the Journal of Accountancy, Association of Government Accountants Topics, the CPA Journal, Government Executive, the CPA Letter, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A20. The Board did 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 considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A21. FASAB received 19 responses from preparers, users of federal financial information, and professional associations. Nearly all respondents agreed with the proposed materiality concepts and their placement in a concepts statement. The placement in a concepts statement provides broad flexibility when exercising materiality judgments, while also providing consistency across standards without overriding existing materiality guidance. In addition, respondents also agreed that this guidance is not significantly different from their current application of materiality in practice.

A22. Some respondents suggested creating a separate chapter in SFFAC 1 regarding materiality due to its importance. After carefully considering the comments received and the fact that materiality concepts may affect a reporting entity at various levels and areas of responsibility, accountability, and mission, the Board decided to place the materiality guidance in SFFAC 1 by creating a new chapter 7 titled *Materiality*.

A23. Based on several respondents' suggestions, the Board modified the following guidance originally proposed in the ED:

a. The Board eliminated the following wording from paragraph164c: "Therefore, misstatements of relatively small amounts could have a material effect on the financial statements. For example, an amount that is not quantitatively material with respect to a very large line item may be material with respect to a smaller line item." This avoids the misinterpretation that each line would have its own unique quantitative materiality value.

b. The Board defined the term "reasonable financial report user (reasonable user)" in footnote 12.2 to ensure consistency and clarity of its use throughout the guidance.

A24. Some respondents suggested providing detailed quantitative and qualitative guidance or references to other existing literature for materiality considerations. The Board concluded that its emphasis on the importance of evaluating both quantitative and qualitative factors in the determination of materiality, without providing specifics, allows entities broader flexibility in exercising materiality judgments. References to existing literature would not be valuable, as it is not the Board's intent to endorse or prioritize these sources. As such, no specific reference to other existing literature is provided.

A25. Several respondents asked about the effect of this guidance on the existing non-authoritative sections of other Statements and the *FASAB Handbook*, where materiality is also discussed. For example, there is a materiality discussion in the Introduction sections of SFFAS 1 and SFFAS 3 and in the Foreword section of the *FASAB Handbook*. These sections are considered non-authoritative guidance and will be updated with a reference to this Statement.

A26. Additionally, the Board observed that existing concepts and standards discuss materiality in the context of management's discussion and analysis (MD&A). SFFAC 3's Figure 1: Schematic Diagram of a Sample General Purpose Federal Financial Report states:

> The assertions and report on control called for by the Federal Managers Financial Integrity Act (FMFIA or Integrity Act) would not be stated in full in MD&A. They would be reported in a discrete section of the GPFFR or incorporated in the GPFFR by reference. They are within the scope of MD&A because highly important aspects of systems, compliance, and internal controls should be discussed in MD&A. "Highly important" in this context may imply a higher threshold than "materiality" for the financial statements.

SFFAS 15, *Management's Discussions and Analysis*, paragraph 5 states:

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.

The issuance of this Statement does not affect the materiality considerations applied to MD&A as stated in SFFAC 3 and SFFAS 15.

Board Approval

A27. This Statement was approved unanimously. The written ballots are available for public inspection at FASAB's office.

Appendix B: Abbreviations

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FN	Footnote
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GAS	Government Auditing Standards
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standard

Statement of Federal Financial Accounting Standards 1: Accounting for Selected Assets and Liabilities

Status

Issued	March 30, 1993
Effective Date	For fiscal years beginning after September 30, 1993.
Affects	None.
Affected by	• Paragraph 53, SFFAS 7, affects paragraph 41, by providing additional guidance regarding accruing accounts receivable. • SFFAS 31 amends paragraphs 26, 29, 31, 37 and 38, and adds paragraph 38a. • SFFAS 32 amends paragraphs 86. • TB 2020-1 clarifies paragraphs 40-52 by providing that recognition of losses applies to both intragovernmental receivables and receivables from nonfederal entities.
Related Guidance	• TR 12, Accrual Estimates for Grant Programs • Interpretation 10, Clarification of Non-federal Non-entity FBWT Classification (SFFAS 1, Paragraph 31)

Summary

This statement defines and illustrates the distinction between Entity Assets and Non-entity Assets, as well as Intragovernmental and Governmental Assets and Liabilities.

Assets available to an entity to use in its operations are entity assets while those assets not available to an entity but held by the entity are non-entity assets. While both entity and non-entity assets are to be reported in entity statements, the standards require the segregation of entity and non-entity assets. In addition, a liability (due to Treasury or other entities) must be recognized in an amount equal to non-entity assets.

Intragovernmental assets and liabilities arise from transactions among federal entities. Governmental assets and liabilities arise from transactions of the federal government or an entity of the federal government with nonfederal entities. The standards require that all selected assets and liabilities addressed in SFFAS No. 1 be reported separately as intragovernmental or governmental assets and liabilities.

The statement also establishes specific standards for six assets: Cash, Fund Balance with Treasury, Accounts Receivable, Interest Receivable, Advances and Prepayments, and Investments in Treasury Securities; and three liabilities: Accounts Payable, Interest Payable, and Other Current Liabilities. The standards provide definitions of each asset and liability as well as recognition, measurement, and disclosure requirements.

Interpretation 10, Clarification of Non-federal Non-entity FBWT Classification (SFFAS 1, Paragraph 31): An Interpretation of SFFAS 1 and SFFAS 31 clarifies SFFAS 1, paragraph 31 by providing that non-federal non-entity amounts received for unfilled orders (including amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process) and deposited into the General Fund of the U.S. Government should be reported as an intragovernmental asset by the component reporting entity.

Table of Contents

Introduction

Objective

1. In this Statement, the Board recommends accounting standards for selected assets and liabilities of the federal government and its entities. The standards apply to both governmental and commercial-type functions of the federal government.

2. The selected assets and liabilities are among the fundamental elements of federal accounting and financial reporting. By recommending these standards in the Board's first Statement, the Board's objective is to provide definitive accounting and reporting guidance to federal agencies in these fundamental areas at the earliest stage of the Board's consideration and development of federal accounting standards.

3. In a separate project, the Board is identifying users' needs and federal accounting and reporting objectives. Although the Board's deliberation on objectives has not been finalized, there is a general consensus that one overall objective for accounting and financial reporting is to assure accountability of federal governmental entities. The Board believes that issuing these selected standards will help in fostering that overall objectives.

4. Specifically, the recommended standards would assist users of financial statements in:

   - assessing the efficiency and effectiveness of the government's management of its assets and liabilities, and
   - determining whether the government's financial position improved or deteriorated over the reporting period.

Approach

5. The Board's initial approach to developing accounting standards was to review the existing accounting standards prescribed by the Government Accountability Office (GAO) in its *Policy and Procedures Manual for the Guidance of Federal Agencies, Title 2 Accounting, (Title 2)*. The purpose of the review was to determine whether some of the *Title 2* standards, with any necessary modifications, could be recommended by the Board to the principals of the Joint Financial Management Improvement Program (JFMIP).

6. Although the *Title 2* standards had not been fully implemented by federal agencies, they represented a starting point for further analysis. The *Title 2* standards were reviewed in light

of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and objectives of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

7. These selected assets and liabilities involve less complex issues than other assets and liabilities to be considered by the Board in the future. The Board also believes that the selected assets and liabilities are so basic to financial reporting that they will not conflict with any conceptual framework that the Board may develop.[1]

8. The standards on the selected assets and liabilities were proposed in the Board's first Exposure Draft issued in September 1991, entitled *Financial Resources, Funded Liabilities, and Net Financial Resources and Federal Entities*. A total of 69 respondents submitted their comments to the Board on the Exposure Draft. A public hearing on the Exposure Draft was held on February 28, 1992.

9. In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and objectives of federal financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, "Basis of the Board's Conclusions."

Scope

10. The selected assets addressed in this Statement are:

- Cash
- Fund Balance with Treasury
- Accounts Receivable
- Interest Receivable
- Advances and Prepayments
- Investments in Treasury Securities

11. The selected liabilities addressed in this Statement are:

[1]The Board is also addressing other assets and liabilities. It has issued a proposed standard for direct loans and loan guarantees (see Exposure Draft entitled *Accounting for Direct Loans and Loan Guarantees*, September 15, 1992, and *Accounting for Inventory and Related Property*, December 1992).

- Accounts Payable
- Interest Payable
- Other Current Liabilities

Materiality

12. Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

13. 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.

Applicability

14. The accounting standards recommended in this Statement are applicable to the federal government and its departments and agencies in the executive branch that fall within the definition of “executive agency” as defined in 31 U.S.C. 102 and 3501.

Effective Date

15. The accounting standards recommended in this Statement will be effective for financial statements prepared for fiscal years beginning after September 30, 1993. Earlier adoption is encouraged.

Explanation

16. The Board’s focus in this Statement is on setting accounting standards for the individual federal entity level of reporting. In this Statement, the standards are also applicable to financial reporting by the U.S. government as a whole, except for those standards related to intragovernmental assets and liabilities, which are defined in the general standards and noted in specific standards.

17. The word “entity” refers to a unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements will be prepared. The word entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements are prepared in accordance with OMB guidance on the form and content of financial statements.

General Standards

Intragovernmental vs. Governmental Assets and Liabilities

18. ***Intragovernmental assets and liabilities*** arise from transactions among federal entities. Intragovernmental assets are claims of a federal entity against other federal entities. Intragovernmental liabilities are claims against the entity by other federal entities.

19. Among the assets covered by this Statement, intragovernmental assets include an entity’s fund balance with Treasury, investments in Treasury securities, accounts and interest receivable from federal entities, and advances and prepayments to federal entities.

20. Intragovernmental liabilities include accounts and interest payable to federal entities and other current liabilities due to federal entities, such as receipt of federal advances and prepayments.

21. ***Governmental assets and liabilities*** arise from transactions of the federal government or an entity of the federal government with nonfederal entities. Governmental assets are claims of the federal government or an entity within the federal government against nonfederal entities. Governmental liabilities are amounts that the federal government or an entity within the federal government owes to nonfederal entities. The term nonfederal entities encompasses domestic and foreign persons and organizations outside the U.S. government. The term public is also used in this Statement to represent nonfederal entities.

22. Among the assets covered by this Statement, governmental assets that would be reported by a federal entity include cash, accounts and interest receivable from nonfederal entities, and advances and prepayments made to nonfederal entities.

23. Governmental liabilities include accounts and interest payable to nonfederal entities, other liabilities due to nonfederal entities, and advances and prepayments received from nonfederal entities.

24. Intragovernmental assets and liabilities should be reported separately from governmental assets and liabilities. This requirement applies to all of the selected assets and liabilities addressed in this document.

Entity Assets vs. Non-entity Assets

25. ***Entity assets*** are those assets which the reporting entity has authority to use in its operations. ***Non-entity assets*** are those assets that are held by an entity but are not available to the entity. An example of non-entity assets are customs duty receivables that the Customs Service collects for the U.S. government but has no authority to spend. A similar example is federal income tax receivable that the Internal Revenue Service collects for the U.S. government.

26. Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements, except for non-entity assets meeting the definition of fiduciary assets, which should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities*. Non-entity assets recognized on an entity's balance sheet should be segregated from entity assets. An amount equal to non-entity assets should be recognized as a liability (due to Treasury or other entities) recognized on the balance sheet.

Specific Standards

Cash

27. *Cash*, including imprest funds, should be recognized as an asset. Cash consists of:

    a. coins, paper currency and readily negotiable instruments, such as money orders, checks, and bank drafts on hand or in transit for deposit;

    b. amounts on demand deposit with banks or other financial institutions; and

    c. foreign currencies, which, for accounting purposes, should be translated into U.S. dollars at the exchange rate on the financial statement date.

28. ***Entity cash.*** Entity cash is the amount of cash that the reporting entity holds and is authorized by law to spend.

29. ***Non-entity cash.*** Non-entity cash is cash that a federal entity collects and holds on behalf of the U.S. government or other entities. In some circumstances, the entity deposits cash in its accounts in a custodial capacity for the U.S. Treasury or other federal component entities, or in a fiduciary capacity for non-federal parties.

    a. Non-entity cash recognized on the balance sheet should be reported separately from entity cash.

    b. Non-entity cash meeting the definition of a fiduciary asset should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities*.

30. ***Restricted cash.*** Cash may be restricted. Restrictions are usually imposed on cash deposits by law, regulation, or agreement. Non-entity cash is always restricted cash. Entity cash may be restricted for specific purposes. Such cash may be in escrow or other special accounts. Financial reports should disclose the reasons and nature of restrictions.

Fund Balance with Treasury

31. A federal entity's *fund balance with the Treasury* (FBWT) 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. FBWT is an intragovernmental item, except for fiduciary or other non-federal non-entity FBWT. From the reporting entity's perspective, the reporting entity's FBWT is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.

32. A federal entity's fund balance with Treasury includes clearing account balances and the dollar equivalent of foreign currency account balances. Foreign currency account balances should be translated into U.S. dollars at exchange rates determined by the Treasury and effective at the financial reporting date. A federal entity's fund balance with Treasury also includes balances for direct loan and loan guarantee activities held in the credit reform program, financing, and liquidating accounts.

33. An entity's fund balance with Treasury is increased by (a) receiving appropriations, reappropriations, continuing resolutions, appropriation restorations, and allocations, and (b) receiving transfers and reimbursements from other agencies. An entity's fund balance with

Treasury is also increased by amounts borrowed from Treasury, Federal Financing Bank, or other entities, and amounts collected and credited to appropriation or fund accounts that the entity is authorized to spend or use to offset its expenditures.

34. An entity's fund balance with Treasury does not include contract authority or unused authority to borrow. *Contract authority* is a statutory authority under which contracts or other obligations may be entered into prior to receiving an appropriation for the payment of obligations. The later enacted appropriation provides cash to liquidate obligations.[2] Thus, contract authority merely permits a federal entity to incur certain obligations but does not, in itself, add funds to the agency's accounts with Treasury.

35. *Authority to borrow* is a statutory authority that permits a federal agency to incur obligations and make payments for specific purposes out of borrowed funds. Authority to borrow adds funds to an agency's accounts with Treasury only after the agency actually uses the authority to borrow a specific amount of funds. Thus, authority to borrow is included in an entity's fund balance with Treasury only to the extent that funds are actually borrowed under the authority.

36. An entity's fund balance with Treasury is reduced by (a) disbursements made to pay liabilities or to purchase assets, goods, and services, (b) investments in U.S. securities (securities issued by Treasury or other federal government agencies), (c) cancellation of expired appropriations; (d) transfers and reimbursements to other entities or to the Treasury, and (e) sequestration or rescission of appropriations.

37. Disclosure should be made to distinguish three categories of funds within the FBWT reported on the balance sheet: the obligated balance not yet disbursed the unobligated balance, and non-budgetary FBWT. The obligated balance not yet disbursed is the amount of funds against which budgetary obligations have been incurred, but disbursements have not been made.

38. The *unobligated balance* is the amount of funds available to an entity against which no claims have been recorded. Unobligated balances are generally available to a federal entity for specific purposes stipulated by law. Unobligated balances may also include balances in expired/canceled accounts that are available only for approved adjustments to prior obligations. Certain unobligated balances may be restricted to future use and are not apportioned for current use. Disclosure should be provided on such restrictions. Non-budgetary FBWT includes unavailable receipt accounts, clearing accounts and other accounts that do not represent budget authority, as well as non-entity FBWT that is recognized on the balance sheet.

[2]Source of definition: OMB Circular A-34.

38a. In addition to entity and non-entity FBWT that is recognized on the balance sheet, a federal entity may also administer fiduciary FBWT on behalf of non-federal entities or individuals. Fiduciary FBWT is not recognized on the balance sheet, but is subject to separate disclosure requirements for fiduciary FBWT, see SFFAS 31, *Accounting for Fiduciary Activities*.

39. Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared.) Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year.

Accounts Receivable

40. Accounts receivable arise from claims to cash or other assets. The accounting standard for accounts receivable is set forth below.

41. ***Recognition of receivables.***[3] A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date, (e.g., taxes not received by the date they are due), or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made. [See SFFAS 7, paragraph 53 for more.]

42. ***Separate reporting.*** Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities.

43. ***Entity vs. Non-entity receivables.*** Receivables should be distinguished between entity receivables and non-entity receivables. ***Entity receivables*** are amounts that a federal entity claims for payment from other federal or nonfederal entities and that the federal entity is authorized by law to include in its obligational authority or to offset its expenditures and liabilities upon collection.[4] ***Non-entity receivables*** are amounts that the entity collects on

[3] The word recognition used in this document bears the same meaning as used by the Financial Accounting Standards Board (FASB) in its conceptual statements. It means 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. FASB Statement of Financial Accounting Concepts No. 5, par. 6.

[4] An entity may have receivables that, once collected, can be used as offsets to the entity's budget authority and outlays only when authorized by Congress. Before receiving the authorization, however, those receivables are non-entity receivables.

behalf of the U.S. government or other entities, and the entity is not authorized to spend.[5] Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity.

44. ***Recognition of losses due to uncollectible amounts.*** Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase *more likely than not* means more than a 50 percent chance of loss occurrence.

45. An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value.[6] The allowance for uncollectible amounts should be reestimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct.

46. ***Measurement of losses.*** Losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole.

47. ***Individual account analysis.*** Accounts that represent significant amounts should be individually analyzed to determine the loss allowance. Loss estimation for individual accounts should be based on (a) the debtor's ability to pay, (b) the debtor's payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

48. The allowance for losses generally cannot be based solely on the results of individual account analysis. In many cases, information may not be available to make a reliable assessment of losses on an individual account basis or the nature of the receivables may not lend itself to individual account analysis. In these cases, potential losses should be assessed on a group basis.

49. ***Group analysis.*** To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics.

50. The groups should reflect the operating environment. For example, accounts receivable can be grouped by: (a) debtor category (business firms, state and local governments, and

[5] Governmental receipts include collections arising from the sovereign and regulatory powers unique to the federal government, e.g., income tax receipts, customs duties, court fines, certain license fees, etc. A federal entity may be responsible for collecting these receipts on behalf of the U.S. government, but is not authorized to use the monies collected to offset its expenditures.

[6] In the Board's Exposure Draft, Accounting for Direct Loans And Loan Guarantees, September 15, 1992, receivables are accounted for on a net present value basis. [See SFFAS No. 2]

individuals), (b) reasons that gave rise to the receivables (tax delinquencies, erroneous benefit payments, trade accounts based on goods and services sold, and transfers of defaulted loans to accounts receivable), or (c) geographic regions (foreign countries, and domestic regions). Within a group, receivables are further stratified by risk characteristics. Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables.

51. Statistical estimation by modeling or sampling is one appropriate method for estimating losses on groups of receivables. Statistical estimation should take into consideration factors that are essential for estimating the level of losses, including historical loss experience, recent economic events, current and forecast economic conditions, and inherent risks.

52. ***Disclosure.*** Agencies should disclose the major categories of receivables by amount and type, the methodology used to estimate the allowance for uncollectible amounts, and the total allowance.

Interest Receivable

53. Interest receivable should be recognized for the amount of interest income earned but not received for an accounting period. Interest receivable should be recognized as it is earned on investments in interest-bearing securities. Interest also should be recognized on outstanding accounts receivable and other U.S. government claims against persons and entities in accordance with provisions in 31 U.S.C. 3717, Interest and Penalty Claims. (See also Federal Claims Collection Standards, 4 CFR Part 103, paragraph 102.13.)[7]

54. No interest should be recognized on accounts receivable or investments that are determined to be uncollectible unless the interest is actually collected. Payments received from the debtor are required to be applied first to penalty and administrative cost charged, second to interest receivable, and third to outstanding debt principal, per Federal Claims Collection Standards, 4 C.F.R. 102.13(f).

55. However, until the interest payment requirement is officially waived by the government entity or the related debt is written off, interest accrued on uncollectible accounts receivable should be disclosed.

56. Interest receivable from federal entities should be accounted for and reported separately from interest receivable from the public.

[7] Accounting for imputed interest, interest on long-term leases, interest on loans, and interest on amounts deposited in credit reform accounts will be addressed when the Board considers accounting standards in these areas.

Advances and Prepayments

57. *Advances* are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee.

58. *Prepayments* are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred. Typical prepaid expenses are rents paid to a lessor at the beginning of a rental period. Progress payments made to a contractor based on a percentage of completion of the contract are not advances or prepayments.

59. Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire. A travel advance, for example, should be initially recorded as an asset and should be subsequently reduced when travel expenses are actually incurred. Amounts of advances and prepayments that are subject to refund (for example, a settled travel claim indicating the traveler owes part of the advance to the government) should be transferred to accounts receivable.

60. Advances and prepayments paid out by an entity are assets of the entity. On the other hand, advances and prepayments received by an entity are liabilities of the entity (see the recommended standard for other current liabilities). In financial reports of an entity, advances and prepayments the entity paid out (assets) should not be netted against advances and prepayments that the entity received (liabilities).

61. Advances and prepayments made to federal entities are intragovernmental items and should be accounted for and reported separately from those made to nonfederal entities.

Investments in Treasury Securities

62. ***Scope.*** This standard applies to investment by federal entities in Treasury securities, including (a) nonmarketable par value Treasury securities, (b) market-based Treasury securities expected to be held to maturity, and (c) marketable Treasury securities expected to be held to maturity. This standard does not apply to investments by federal entities in securities (debt and equity) and other financial instruments issued by other than the U.S. Treasury.

63. *Nonmarketable par value Treasury securities* are special series debt securities that the U.S. Treasury issues to federal entities at face value (par value). The securities are redeemed at face value on demand; thus investing entities recover the full amounts invested.

64. *Market-based Treasury securities* are debt securities that the U.S. Treasury issues to federal entities without statutorily determined interest rates. Although the securities are not marketable, their terms (prices and interest rates) mirror the terms of marketable Treasury securities.

65. *Marketable Treasury securities*, including Treasury bills, notes, and bonds, are initially offered by Treasury to the marketplace and can then be bought and sold on securities exchange markets. Their bid and ask prices are publicly quoted by the marketplace.

66. ***Treasury securities expected to be held to maturity.*** Aside from nonmarketable par value Treasury securities, this standard applies to market-based and marketable Treasury securities that are expected to be held to maturity. An investment in securities is *expected to be held to maturity* only if the investing entity has the intent and ability to hold those securities to maturity. An investment in Treasury securities should not be considered as expected to be held to maturity if the investing entity is likely to sell the securities in response to short-term cash needs, changes in market interest rates, or for other reasons.

67. ***Separate accounting and reporting for federal and nonfederal securities.*** Investments of a federal entity in U.S. securities (securities issued by Treasury and federal agencies) are intragovernmental investments. These U.S. securities also represent intragovernmental liabilities of the Treasury Department or other federal entities that issue the securities. Investments in securities issued by the U.S. Treasury or other federal entities should be accounted for and reported separately from investments in securities issued by nonfederal entities.

68. ***Initial recording.*** The three types of Treasury securities covered by this standard (nonmarketable par value Treasury securities, market-based Treasury securities expected to be held to maturity, and marketable Treasury securities expected to be held to maturity) should be recognized at their acquisition cost. If the acquisition is made in exchange for nonmonetary assets, the acquired securities should be recognized at the fair market value of either the securities acquired or the assets given up, whichever is more definitively determinable.

69. If the acquisition cost differs from the face (par) value, the security should be recorded at the acquisition cost, which equals the security’s face value plus or minus the premium or discount on the investment. A discount is the excess of the security’s face amount over its purchase price. A premium is the excess of the purchase price over the security’s face

value. The balance in the valuation account is treated as a contra account to the debt security.

70. ***Valuation subsequent to acquisition.*** Subsequent to their acquisition, investments in Treasury securities should be carried at their acquisition cost, adjusted for amortization, if appropriate, as explained below.

71. If an amount of premium or discount exists, the carrying amount of the investments should be adjusted in each reporting period to reflect the amortization of the premium or the discount. Premiums and discounts should be amortized over the life of the Treasury security using the interest method. Under the interest method, the effective interest rate (the actual interest yield on amounts invested) multiplied by the carrying amount of the Treasury security at the start of the accounting period equals the interest income recognized during the period (the carrying amount changes each period by the amount of the amortized discount or premium). The amount of amortization of discount or premium is the difference between the effective interest recognized for the period and the nominal interest for the period as stipulated in the Treasury security. (See Appendix B for an illustration of the interest method of amortization.)

72. ***Disclosure of market value.*** For investments in market-based and marketable Treasury securities, the market value of the investments should be disclosed. For purposes of determining a market value, investments should be grouped by type of security, such as marketable or market-based Treasury securities. The market value of investments in a group is calculated by the market price of securities of that group at the financial reporting date multiplied by the number of notes or bonds held at the financial reporting date.

73. ***Investment reclassification.*** In rare instances, significant unforeseeable circumstances may cause a change in an entity's intent or ability to hold to maturity certain securities that are initially classified as expected to be held to maturity. In these circumstances, the affected securities should be reclassified as securities available for sale or early redemption (redemption before the security's maturity). Once a security is reclassified it is no longer subject to this standard.

Accounts Payable

74. Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities.

75. Accounts payable are not intended to include liabilities related to on-going continuous expenses such as employees' salary and benefits, which are covered by other current liabilities. (See recommended standard for Other Current Liabilities.)

76. Amounts owed for goods or services received from federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public.

77. When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.

78. When a contractor provides the government with goods that are also suitable for sale to others, the liability usually arises when the contractor physically delivers the goods and the government receives them and takes formal title. However, when a contractor builds or manufactures facilities or equipment to the government's specifications, formal acceptance of the products by the government is not the determining factor for accounting recognition. Constructive or de facto receipt occurs in each accounting period, in accordance with the following paragraph.

79. For facilities or equipment constructed or manufactured by contractors or grantees according to agreements or contract specifications, amounts recorded as payable should be based on an estimate of work completed under the contract or the agreement. The estimate of such amounts should be based primarily on the federal entity's engineering and management evaluation of actual performance progress and incurred costs.

80. The reporting entity should disclose accounts payable not covered by budgetary resources.

Interest Payable

81. Interest payable should be recorded for the amount of interest expense incurred and unpaid. Interest incurred results from borrowing funds from Treasury, Federal Financing Bank, other federal entities, or the public. Interest also should be recorded on late payment of bills by the federal entity (see provisions in 31 U.S.C. 3901 through 3907, Prompt Payment) and on refunds (see provisions in 26 U.S.C. 6611). Interest payable of an entity on borrowed funds and unpaid bills should be recognized at the end of each period.

82. Interest payable to federal entities is an intragovernmental liability and should be accounted for separately from interest payable to the public.

Other Current Liabilities

83. The term *other current liabilities* is used to report current liabilities that are not recognized in specific categories such as accounts payable; interest payable; debt owed to the public, Treasury, or other entities; and liabilities for loan guarantee losses. Other current liabilities may include unpaid expenses that are accrued for the fiscal year for which the financial statements are prepared and are expected to be paid within the fiscal year following the reporting date.

84. Typical examples of other current liabilities to be recognized are: (a) accrued employees' wages, bonuses, and salaries for services rendered in the current fiscal year for which paychecks will be issued in the following year; (b) accrued entitlement benefits payable, such as Old Age Survivors Insurance (OASI) and Veterans Compensation and Pension benefits applicable to the current period but not yet paid, and (c) annuities for the current fiscal year administered by trust, pension, or insurance programs for which payment would be made in the following fiscal year. Such liabilities may be presented on the face of the financial reports as *Other Current Liabilities* or as one or more separate categories depending on the materiality of the amounts.

85. Federal entities may receive advances and prepayments from other entities for goods to be delivered or services to be performed. Before revenues are earned, the current portion of the advances and prepayments should be recorded as other current liabilities. After the revenue is earned (goods or services are delivered, or performance progress is made according to engineering evaluations), the entity should record the appropriate amount as a revenue or financing source and should reduce the liability accordingly. Other current liabilities due to federal entities are intragovernmental liabilities that should be reported separately from those due to employees and the public.

86. The reporting entity should disclose the amount of current liabilities not covered by budgetary resources. The U.S. government-wide financial statements need not include this disclosure.

Appendix A: Basis Of The Board's Conclusions

87. This Appendix provides a discussion on the substantive comments that the Board received from respondents to Exposure Draft No. 1, "Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities" (November 18, 1991) and from testimony at a public hearing on the Exposure Draft held February 28, 1992. The Appendix explains the basis of the Board's conclusions on issues raised by the respondents.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Basic Concepts

88. ***Net financial resources.*** In the Exposure Draft, the Board proposed the concept of net financial resources . The term net financial resources was referred to as an entity's total financial resources less its total funded liabilities (Exposure Draft, page 11). The Exposure Draft stated that the amount of net financial resources provides a general measure of an entity's financial sufficiency before new appropriations are provided. The Exposure Draft further stated that information on the components of an entity's net financial resources (obligated and unobligated balances of budget authority and other items) can provide additional insight into an entity's financial situation.

89. Many respondents do not see convincing evidence that the concept of net financial resources is useful. They point out that there are no concrete examples to illustrate how the information can be used. Some respondents also do not believe that the measure of net financial resources is well defined. They point out that one of the elements missing from the concept is the amount of unfunded liabilities. They state that without measuring unfunded liabilities, the measure of net financial resources is incomplete and can be misleading.

90. The Board has decided to postpone consideration of the net financial resources concept. The Board believes that the usefulness of the concept can be further explored after it completes its project on users' needs and objectives for financial accounting and reporting.

91. ***Entity financial resources.*** In the Exposure Draft, the Board discussed the concept of entity financial resources. The concept was defined as assets of a federal entity that consist of (a) the entity's cash and funds authorized and available for disbursement (excluding contract authority and unused authority to borrow), (b) resources of the entity that are

expected to be converted into cash to satisfy liabilities, and (c) conversion of cash into another form (for example prepayments) that would be consumed. Under this definition, the Exposure Draft identified as financial resources: cash, funds with Treasury, claims to cash (for example accounts receivable and loans receivable), claims to goods and services (for example advances and prepayments), inventories held for sale, and investments.

92. As indicated in the Exposure Draft, financial resources are a subset of assets that provide liquidity (cash and assets that can be converted to cash) to meet a federal entity's operational needs. The concept was considered useful because federal entities obtain resources from the budget to finance their operations and are held accountable for the use of the financial resources.

93. The Board has decided not to use the term financial resources in this document. However, a definition of the term financial resources and its usefulness will be further considered by the Board in its conceptual framework project. In the absence of the term, the items that would provide future economic benefits to the government and its entities are referred to as assets. The term asset as used in this document means an item that embodies a probable future economic benefit that can be obtained or controlled by the federal government or a reporting entity as a result of past transactions or events. (The definition of assets will be considered by the Board in the future.)

94. ***Funded liabilities.*** The Exposure Draft proposed the definition of "funded liabilities" as "liabilities for which the federal entity has received budget authority to cover the related expenditure or expense."

95. The term "funded liabilities" would limit the recognition of liabilities to the extent that they are funded. The Board believes that the liabilities addressed in this document should be recognized when they are incurred, regardless of whether they are funded. The Board therefore decided not to use the term "funded liabilities" in this document. However, the Board recommends that disclosure be made for liabilities that are not covered by budgetary resources.

96. The word "liability" used in this document means a probable and measurable future outflow of resources arising from past transactions or events.[8] A comprehensive definition of liabilities is being considered by the Board in its project concerning liabilities in general. However, this document addresses only those selected liabilities that routinely recur in normal operations and that are due within a fiscal year. These liabilities are accounts payable, interest payable, and other current liabilities. The category of other current

[8] A comprehensive definition of "liabilities" is being considered by the Board in its project concerning liabilities in general. [See SFFASs 5 and 12 for more on liabilities.]

liabilities includes salary and entitlement benefit expenses that are accrued and would be paid within a fiscal year.

General Standards

97. The recommended standards apply to reporting by the federal government and its entities for both governmental assets and liabilities and intragovernmental assets and liabilities reported at the entity level.

98. An entity may have two categories of assets and liabilities   intragovernmental and governmental assets and liabilities. The difference between intragovernmental and governmental assets and liabilities is explained below:

    (1) ***Intragovernmental assets and liabilities.*** These assets and liabilities arise from intragovernmental transactions. For example, investments held by a federal entity in Treasury securities are reported by the entity as an asset. However, the Treasury securities also are liabilities of the Department of the Treasury. Thus, the securities represent intragovernmental assets and liabilities. Another example is fund balance with Treasury. An entity's fund balance with Treasury of an entity will be reported as an asset by the entity. However, it is not an asset of the federal government; rather, it is a commitment of the U.S. government to provide funds to a federal entity. (See discussion, which follows, on Fund balance with Treasury.)

    (2) ***Governmental assets and liabilities.*** These are assets and liabilities that arise from transactions of the federal government with nonfederal entities (persons and organizations outside the U.S. government, either foreign or domestic). For example, income taxes to be collected from the public are reported on IRS financial statements as receivables. These receivables are assets of the federal government.

99. The recommended standards require that intragovernmental assets and liabilities be reported separately from governmental assets and liabilities.

100. Assets reported by an entity also are distinguished between entity and non-entity assets.

    (1) ***Entity assets.*** Entity assets are assets that are available to an entity for its use. Entity assets include both intragovernmental and governmental assets. Supplies inventory held by an entity for consumption in its operations is an entity asset as well as a governmental asset. A receivable of a federal entity from another federal entity is an entity asset if the receiving entity has authority to use the amount collected.

(2) ***Non-entity assets.*** An entity may have assets under its custody and management that the entity is not authorized to use. In this Statement, these assets are called non-entity assets, as distinguished from entity assets that the entity is authorized to use in its operations. For example, customs duty receivables to be collected by the Customs Service is a non-entity asset that would be reported by the Customs Service.

101. The Board recommends that both entity assets and non-entity assets under an entity's custody or management be recognized in the entity's financial statements. Non-entity assets should be separately reported in an entity's financial statements.

102. The following exhibit, using receivables as an example, illustrates the relationship between entity and non-entity assets on one hand and intragovernmental and governmental assets on the other hand.

Accounts Receivable

	Entity Assets	**Non-Entity Assets**
Intra-governmental Assets	Amounts receivable from a federal entity for goods or services delivered that will be available to the receiving entity to spend.	Amounts to be collected from a federal entity that will not be available to the receiving entity to spend.
Governmental Assets	Amounts receivable from a nonfederal entity for goods or services that will be available to the receiving entity to spend.	Amounts (such as taxes) to be collected from a nonfederal entity that will not be available to the receiving entity to spend.

Specific Standards

Cash

103. The Board has retained from the Exposure Draft the requirement for separate reporting of restricted and unrestricted cash. However, after considering comments on the Exposure Draft, the Board has modified the definition of restricted cash.

104. The Exposure Draft proposed that unrestricted cash include amounts in demand deposits. However, whether an amount of cash is restricted does not depend on where the cash is kept. For example, federal entities may hold cash in demand deposit accounts on behalf of Treasury. Since the entities have no authority to spend the cash, from the entities' perspective, these amounts of cash are restricted.

105. The recommended standard in this document redefines restricted cash as (1) amounts of cash that an entity holds on behalf of Treasury or other entities and does not have authority to spend, and (2) amounts of cash that are legally restricted to specific purposes.

Fund Balance with Treasury

106. The recommended standard provides guidance on the composition of fund balance with Treasury. Events that cause an entity's fund balance to increase include receiving appropriations, allocations, transfers, receipts that the entity is authorized to spend (or to use to offset its expenditures) and borrowing from Treasury. An entity's fund balance is reduced by amounts disbursed to pay liabilities and expenditures, amounts invested in securities, amounts of appropriations canceled or rescinded, and amounts transferred to other agencies or to the Treasury.

107. With respect to fund balance with Treasury, the Board has considered the following issues:

(1) Is fund balance with Treasury an asset?

108. The Board believes that from the perspective of a federal entity (such as a bureau, a program, or a fund), fund balance with Treasury is an asset. In fact, it is the most important source against which an entity can make expenditures and incur liabilities.

109. However, the Board recognizes that a fund balance with Treasury is an intragovernmental item. It represents a entity's authorized claim to the federal government's resources on one hand, and the government's commitment to supply resources to the entity on the other hand. The claims and commitments would not be reported when financial reports of individual entities are consolidated on a government-wide level. Thus, from the perspective of the federal government as a whole, fund balances with Treasury are not assets of the federal government.

(2) How does fund balance with Treasury relate to budgetary resources?

110. A fund balance is created by budget authority. An appropriation is the major form of budget authority that creates a fund balance with Treasury for an entity. Thus, the relationship between fund balance with Treasury and budget authority cannot be ignored.

111. However, an entity's fund balance with Treasury does not necessarily equal its budgetary resources. The difference between these two concepts may be clarified by examining their definitions. A fund balance represents the sum of amounts that is actually available in an entity's accounts with Treasury. Budgetary resources on the other hand encompass all authorities for an entity to incur obligations. Some of the authorities do not in themselves

provide funds to the entity. Contract authority, for example, allows an entity to incur obligations under a contract. However, it does not, in itself, provide funds to the entity's accounts with Treasury. An appropriation is necessary for the entity to have funds to liquidate obligations incurred under contract authority.

112. Authority to borrow does not in itself place funds into an entity's accounts with Treasury. In order to increase its fund balance with Treasury, an entity must actually borrow under its borrowing authority.

113. For these reasons, the recommended standard states that fund balance with Treasury does not include contract authority and unused authority to borrow.

(3) Should the fund balance exclude funds designated for special purposes?

114. Some respondents to the Exposure Draft believe that the standard should identify funds held with Treasury that are not available to the entity's operations. For example, the Department of Energy collects fines levied under the Emergency Petroleum Allocation Act of 1973, deposits those funds in an escrow account with Treasury, and ultimately disburses those funds to injured parties or for other uses as directed by court decisions.

115. It is not unusual that funds in certain accounts are held and restricted to specific purposes. Amounts of trust funds, for example, are held for the specific purpose of making benefit payments to eligible recipients. The restriction on funds held for the Department of Energy to pay persons injured by oil pricing and allocation violations is another example. The Board believes that the fund balance of a reporting entity should include funds held in all accounts of the entity regardless of whether they are designated for specific purposes.

Accounts Receivable

116. Respondents raised issues related to the recognition and measurement of losses due to uncollectible amounts. Before addressing the Board's actions in relation to respondents' comments, however, the terms recognition and measurement as used in this Statement are explained below:

117. **Recognition** means formally recording or incorporating an item into the records and financial statements as an asset, liability, expense, revenue, or similar element. For assets or liabilities, recognition encompasses subsequent changes to the amounts of assets and liabilities.

118. **Measurement** is the process of expressing an asset or liability in monetary units. Measuring an item requires selecting an appropriate measurement attribute such as historical cost, current market value, net realizable value, or present value of future cash flows.

119. In the proposed standard and the discussion of accounts receivable, the term recognition concerns the timing of recording an asset or the impairment of an asset in the financial records. The term measurement concerns the valuation basis and the dollar amount of the asset that should be reported.

120. Detailed discussions of respondents' comments and the Board's actions are provided in the following paragraphs.

121. ***Timing of receivable recognition.*** The Exposure Draft states that a receivable should be recorded when events (e.g., payment due dates) or transactions occur that entitle an entity to accrue revenue or receive a reimbursement or fund transfer. Some respondents questioned the use of payment due dates as a criterion for recognizing receivables. These respondents stated a receivable should be recognized when an entity is owed an amount or earns a revenue, and that due dates are irrelevant.

122. Some receivables result from exchange transactions. For example, receivables may result from goods and services provided to other entities. However, claims to cash or other assets also result from the federal government's legal authority to levy taxes and impose duties, fees and fines. These receivables are not related to revenue-earning functions or exchange transactions, but are based on the federal government's authority to collect the payments and a party's liability to pay cash or provide other assets to cover the claims. For the accrual of taxes, the tax due date represents the date that the government demands payment. The payment due date is a definitive criterion for accruing taxes.

123. The Board, therefore, recommends that a receivable be recognized when a claim to cash or other assets is established based either on goods or services provided or the government's legal authority to levy and collect. The Board is not recommending a revenue recognition standard at this time.

124. ***Loss recognition.*** In the Exposure Draft, it was proposed that a loss be recognized when it is more likely than not that a receivable has been impaired. The phrase more likely than not means a greater than 50 percent probability of occurrence.

125. Several respondents questioned why the Board used the more likely than not criterion for loss recognition instead of the probable criterion used in the private sector under generally accepted accounting principles (GAAP).[9]

126. The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However,

[9] FASB Statement of Standards No. 5, *Accounting for Contingencies*.

the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors are not relevant to the federal government.

127. In the case of loss recognition on receivables, the Board believes that there should be a definitive guideline for recognizing government credit losses. The word probable is subject to broad interpretation (often being interpreted as meaning a virtual certainty of occurrence) and could allow for belated recognition of losses.

128. The Board proposed the more stringent criterion of more likely than not, which requires the recognition of losses when there is more than a 50 percent chance that some receivables will not be collected. In recommending the more likely than not criterion, the Board's intent is to achieve unbiased, consistent, and reliable loss recognition in federal government accounting.

129. The more likely than not criterion can be applied to both individual accounts and groups of accounts. Both significant individual accounts receivable (e.g., unusually large refunds due from contractors, medicaid reimbursements from third parties, substantial tax delinquencies, or other large claims) and groups of small accounts should be analyzed and losses recognized if it is more likely than not that some or all of the amounts owed will not be collected.

130. When applying the loss recognition criterion, the Board believes it is appropriate to recognize the nature of federal receivables. Many of the federal government's receivables, unlike trade accounts of private firms or loans made by banks, are not created through credit screening procedures. These receivables arise because of activities such as fines from regulatory violations, refunds from erroneous benefit payments, reimbursements, and overdue taxes and duties. In these circumstances, historical experience and economic factors indicate that the receivables frequently are not fully collectible. These receivables meet the loss recognition test because of their inherent risk. Therefore, an appropriate amount of allowance for losses should be recognized at their inception.

131. ***Loss measurement.*** Because of the large volume of federal transactions, accounts receivable generally exist in large groups. Some groups may consist of several hundred thousand accounts. In such cases, losses on uncollectible amounts should be assessed on a group basis using statistical sampling techniques. Statistical sampling should be supplemented by historical trend experience, adjusted for current conditions.

132. On the other hand, some government receivables arise from transactions of significant amounts. These receivables should be individually analyzed to assess losses due to risks specifically attributable to the individual accounts. The assessment of impairment of individual accounts may not always provide a valid basis to estimate the impairment of the

entire group. Often, losses may exist for the group that are not currently identifiable on an individual basis. The Board believes that the federal government's receivables are generally subject to losses due to inherent risks. Therefore, allowances for receivables should be viewed in the context of the overall risk of the receivables being assessed.

133. Based on the above considerations, the recommended standard provides that, for reporting purposes, losses on accounts receivable should be determined by evaluating accounts on both a group and an individual basis.

Interest Receivable

134. In the Exposure Draft, the proposed standard requires that interest be recognized on a receivable until the receivable is repaid or written off. At the same time, the proposed standard requires that an allowance for uncollectible interest be provided. The intent of the proposed standard is to establish the debtor's liability for the accrued interest.

135. Some respondents expressed concern that there is usually a lengthy period from the time a receivable is determined to be uncollectible until it is written off. It would be burdensome to recognize interest on the uncollectible receivable and, at the same time, offset the amount of interest recognized by an allowance for uncollectible interest.

136. The initial intent of this procedure was to maintain a correct amount of the debtor's liability. This purpose can be achieved by record-keeping procedures rather than financial reporting. Therefore, for financial reporting, the Board has concurred that (a) interest receivable should be recognized only on collectible accounts, and
(b) interest receivable on uncollectible accounts should be recognized only when it is actually received.

Advances and Prepayments

137. There were no comments on the substance of the recommended accounting standard for advances and prepayments since the standard does not contain significant changes from the current accounting practice within federal government agencies. Some respondents requested that the Board clarify that prepayments do not include progress payments made on long-term contracts. Since progress payments are made based upon percentage of completion of a contract, the Board concluded that progress payments are not advances or prepayments.

138. Comments were also received questioning whether advances and prepayments should be included within the definition of financial resources (as proposed in the Exposure Draft)

since advances and prepayments are not usually converted to cash or budget authority available for use by the entity.

139. The Board recognizes that, as in the case of inventories held for consumption, advances and prepayments convert into goods and services, but do not convert into cash. However, since the term financial resources is not used in this Statement, the issue is now moot. Advances and prepayments normally benefit current operations and, therefore, are normally considered current assets.

Investments in Treasury Securities

140. The recommended standard applies to investments in Treasury securities, including (1) nonmarketable par value Treasury securities, (2) market-based Treasury securities held to maturity, and (3) marketable Treasury securities held to maturity.

141. In the future, the Board will address investments that are not covered by this standard. In the interim, federal entities should continue their current accounting practices for those investments not covered by this standard.

142. Federal entities, particularly the Social Security and the retirement trust funds, invest available funds in excess of their current needs in special Treasury securities issued in the government account series. The terms of the Treasury securities are usually designed to meet the cash needs of government accounts. The vast majority of the investments are in nonmarketable Treasury securities issued exclusively to federal agencies. Most of them are par value securities, and some are market-based securities whose prices and interest rates reflect market terms. Thus, although the scope of the recommended standard is limited, it covers more than 90 percent of federal entities' investments.

143. A few federal entities are permitted to buy and sell marketable Treasury securities on the open market. Some federal entities which conduct business with the public or provide insurance to the private sector may acquire marketable Treasury securities as a part of a rescue and takeover transaction. This standard applies to marketable Treasury securities only to the extent that they are expected to be held to maturity.

144. In the Exposure Draft, the Board proposed that investments in par value nonmarketable Treasury securities be reported at cost. The Board also proposed that marketable securities and market-based Treasury securities be reported at market value as of the reporting date.

145. A number of respondents, however, expressed concern with the recognition of increases and decreases in assets based on market value, and the recognition of associated gains or losses. These respondents believe these are unrealized gains and losses which do not

represent actual increases or decreases in assets. Some respondents also indicated that market value fluctuations generally do not affect an entity's investments in securities intended to be held to their maturity.

146. In this Statement, the Board continues to use the cost based valuation for nonmarketable par value Treasury securities. The cost basis is appropriate for this type of security because the invested amounts will be fully recovered at redemption.

147. The Board also recommends the cost or amortized cost basis for the valuation of market-based Treasury securities and marketable Treasury securities that are to be held to maturity. The Board believes that the cost basis is appropriate because the invested amounts can be fully recovered when the Treasury securities mature. During the time periods when the securities are outstanding, the market prices of the securities may fluctuate due to interest rate changes or other temporary causes. However, so long as the securities are not to be sold to the market, the investing entity would not be affected by such market price fluctuations. For this reason, the Board decided to recommend the cost based approach rather than market value approach for marketable Treasury securities expected to be held to maturity.

148. The Board considered the valuation issues related to securities not covered by this standard. The Board has concluded that the use of a fair value approach pertains to a broad conceptual issue that needs to be addressed in its conceptual framework. Until the Board reaches decisions on the conceptual framework, it is premature to recommend a valuation basis for securities beyond those covered by this standard.

149. The Board believes that the criteria for classifying an investment as expected to be held to maturity should be based on the intent and ability of the investing entity to hold the security to its maturity. Intent and ability differ from a mere absence of an intent to sell the security. An evaluation of whether an entity has the intent and ability to hold its investments should be based on the entity's current and projected financial condition and its recent pattern in buying, selling, and managing Treasury securities. A security should not be classified as expected to be held to maturity if for cash needs or other investment management reasons the investing entity is not able to hold the security to its maturity.

150. At each financial reporting date, the appropriateness of this classification should be reassessed. In rare instances, an entity's originally stated intent or ability to hold a security to maturity may change due to significant unforeseen changes in the entity's cash needs or in other circumstances. When this occurs, securities initially classified as expected to be held to maturity should be reclassified to securities available for sale or early redemption.

Accounts Payable

151. Accounts payable are set up to record an entity's liability for goods and services received or work progress made by a contractor for which payment has not been made.

152. Some respondents questioned the timing of recognizing a liability in accounts payable. A federal entity, under budgetary accounting, records an obligation when the entity places a purchase order or signs a contract. An obligation, once incurred, reduces an entity's resources available for obligation. Budgetary accounting entries are required to record the amounts obligated and to reduce the available budget authority. For financial reporting purposes, liabilities are recognized when goods and services are received or are recognized based on an estimate of work completed under a contract or agreement.

153. Some federal entities believe it is appropriate to recognize a liability in accounts payable when a purchase order is placed. The theory of this practice is that the purchase order represents a use of the entity's budgetary resources and that recognizing the liability would correctly reduce the entity's available budgetary resources.

154. Proponents for this practice also argue that, in many cases, goods produced under government contracts bear unique specifications for government needs and, as a result, cannot be sold to other customers. Thus, they argue that it is virtually certain that the government has incurred a liability toward the contractor.

155. The Board recognizes that there is a need to reconcile budget execution results and financial effects. In budgetary accounting, when a purchase order is placed, an obligation is recorded to ensure budgetary control. However, recognition of the claim from a financial accounting standpoint does not occur until goods are delivered, work progress is actually made by a contractor, or services are performed since these events generally trigger a cash outlay that liquidates the obligation. The Board does not believe that recognizing a liability prior to a actual receipt or constructive receipt of goods or services should be adopted as a financial accounting standard. It also does not believe that it is appropriate to erase the distinction between recording obligations for budget purposes and recognizing a liability for financial accounting purposes.

156. Some respondents question whether a liability should be recognized for multi-year contracts that are to be financed through appropriations over a number of years. As has been discussed earlier, when a contract is entered, an obligation is recognized in budgetary accounting. However, until goods or services are received or work progress is made, the Board does not believe that an obligation should be recognized as a liability. When goods or services are received or work progress is made under either a short or long-term contract, a liability for unpaid amounts should be recognized.

Interest Payable

157. There were no substantial comments on the recommended accounting standard for interest payable. The recommended standard does not differ from the current accounting practice within federal government agencies.

Other Current Liabilities

158. The recommended standard covers the current liabilities that are not specifically defined in other standards. Current liabilities specifically defined in this Statement are accounts payable and interest payable. Accounts payable and interest payable represent liabilities arising from discrete transactions. The Board also plans to issue statements to define other specific liabilities such as liabilities incurred under a loan guarantee contract and borrowings from other entities.

159. Other current liabilities generally are related to on-going and continuous expenses, which are typically recognized throughout each accounting period rather than on an individual transaction basis. A typical example is the liability for employees salary that is accrued at the end of a fiscal year but is not paid.

160. The Exposure Draft indicated that a liability was considered funded if the related expense was incurred under budget authority. Some respondents suggested that the term budget authority be changed to budgetary resources . They argued that budgetary resources encompass not only new budget authority, but also other resources available to incur liabilities for specified purposes in a given year.

161. The Board agrees that a liability (or a portion of the liability) should be considered funded from the reporting entity's perspective if it is covered by available budgetary resources. However, the recommended standard takes the position that a liability should be recognized when it is incurred, regardless of whether it is covered by available budgetary resources. The recommended standard also requires that disclosure should be made for liabilities that are not covered by available budgetary resources.

Appendix B: Illustration Of The Interest Method For Investment Discount And Premium

This Appendix provides an illustration of the interest method for amortizing a discount or premium of an investment in a marketable or a market-based Treasury security, such as a Treasury bond. The interest method is required in the recommended standard for investments. Before explaining the interest method itself, the concept of discount and premium will be explained.

Bond Discount And Premium

The price of a bond equals the present value of the bond's net future cash flows, including principal and interest payments, discounted to the time of its issuance. The discount rate is referred to as the effective interest rate. Since the effective interest rate usually equals the market interest rate, it may differ from the stated interest rate (the coupon rate) of the bond. The difference between the effective interest rate of a bond and its stated interest rate causes the bond price to be different from its face amount.

A Treasury bond may be purchased at a price higher or lower than the bond's face amount (par amount). The difference between the purchase price and the face amount is a discount if the price is lower than the face amount; or a premium if the price is higher than the face amount. The investor initially records the bond at its face amount and records the discount or the premium in a valuation allowance account. Thus, the carrying amount of the bond equals its face amount minus or plus the discount or the premium. The discount or the premium is amortized over the life of the bond, so that the bond would be redeemed at its face amount at its maturity.

The Interest Method

Under the interest method of amortization,[10] 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 amount of 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

[10] The interest method of amortization is described in several FASB statements and APB Opinions. For example, see paragraph 18, FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, and paragraph 16 of APB Opinion No. 12, *Omnibus Opinion*.

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.

Examples

In the first example,[11] which shows the amortization of a discount, Treasury bonds with the face amount of $100,000 were purchased by a federal entity on the bonds' issuance date, January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is $96,007, with a discount of $3,993, which reflects an effective interest rate of 8 percent.

In Table 1 below, the annual discount amortization is in column 4, which equals column 3 minus column 2.

Table 1: Discount Amortization

Date	Stated Interest 7%	Effective Interest 8%	Discount Amortization	Unamortized Balance	Bonds Carrying Amount
1/1/92				$3,993	$ 96,007
12/31/92	7,000	$7,681	$681	3,312	96,688
12/31/93	7,000	7,735	735	2,577	97,423
12/31/94	7,000	7,794	794	1,783	98,217
12/31/95	7,000	7,857	857	926	99,074
12/31/96	7,000	7,926	926	0	100,000

In the second example, which is the amortization of a premium, Treasury bonds with the face amount of $100,000 were purchased by a federal entity on the bonds' issuance date January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is $104,212, with a premium of $4,212, which reflects an effective interest rate of 6 percent.

In Table 2 below, the annual premium amortization is in column 4, which equals column 2 minus column 3.

[11]The examples are adapted from Glenn A. Welsch and Charles T. Zlatkovich, Intermediate Accounting, 8th ed. (Boston: Richard D. Irwin, Inc., 1989), p. 656.

Table 2: Premium Amortization

Date	Stated Interest 7%	Effective Interest 6%	Premium Amortization	Unamortized Balance	Bonds Carrying Amount
1/1/92				$4,212	$104,212
12/31/92	7,000	$6,253	$747	3,465	103,465
12/31/93	7,000	6,208	792	2,673	102,673
12/31/94	7,000	6,160	840	1,833	101,833
12/31/95	7,000	6,110	890	943	100,943
12/31/96	7,000	6,057	943	0	100,000

Appendix C: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

Statement of Federal Financial Accounting Standards 2: Accounting for Direct Loans and Loan Guarantees

Status

Issued	August 23, 1993
Effective Date	For fiscal years beginning after September 30, 1993.
Affects	None.
Affected by	• SFFAS 18 • SFFAS 19 • SFFAS 32 amends par. 56
Related Guidance	TR 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* TR 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*

Summary

The Statement provides accounting standards for federal direct loans and loan guarantees. The standards require that direct loans obligated and loan guarantees committed after September 30, 1991, be accounted for on a present value basis. The use of the present value accounting method is consistent with the intent of the Federal Credit Reform Act of 1990.

The standards contain the following essential requirements:

- **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.
- 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.
- 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.
- The subsidy cost allowance for direct loans and the liability for loan guarantees are **reestimated** each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).

- When direct loans or loan guarantees are **modified**, the cost of modification is recognized at an amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.
- Upon **foreclosure** of direct or guaranteed loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.

The standards permit but do not require restating pre-credit reform direct loans and loan guarantees at present value.

Table of Contents

Executive Summary

1. The Statement provides accounting standards for federal direct loans and loan guarantees. The standards require that direct loans obligated and loan guarantees committed after September 30, 1991, be accounted for on a present value basis. The use of the present value accounting method is consistent with the intent of the Federal Credit Reform Act of 1990.

2. The standards contain the following essential requirements:

   - 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.
   - 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.
   - 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.
   - The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).
   - When direct loans or loan guarantees are modified, the cost of modifications is recognized at an amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.
   - Upon foreclosure of direct or guaranteed loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.

3. The standards permit but do not require restating pre-credit reform direct loans and loan guarantees at present value.

Introduction

Background

4. The federal government, in discharging its responsibility to promote the nation's general welfare, makes DIRECT LOANS[1] and guarantees loans to segments of the population not adequately served by nonfederal financial institutions. Examples of federal CREDIT PROGRAMS include farmers' home loans, small business loans, veterans' mortgage loans, and student loans. For those unable to afford credit at the market rate, federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom nonfederal financial institutions would be reluctant to grant credit because of the high risk involved, federal credit programs guarantee the payment of these nonfederal loans, absorbing the costs of defaults.

5. Because federal credit programs provide interest subsidies and sustain losses caused by defaults, the costs of these programs are significant. It is crucial, therefore, that the actual and expected costs of federal credit programs be fully recognized in both budget and financial reporting.

The Federal Credit Reform Act Of 1990

6. The primary intent of the Federal Credit Reform Act of 1990 is to ensure that the SUBSIDY COSTS of direct loans and LOAN GUARANTEES are taken into account in making budgetary decisions. To achieve this general result, the Act has the following specific purposes: (a) ensure a timely and accurate measure and presentation in the President's budget of the costs of direct loan and loan guarantee programs, (b) place the cost of credit programs on a budgetary basis equivalent to other federal spending, (c) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries, and (d) improve the allocation of resources among credit programs and between credit and other spending programs.

7. The major provisions of the Act, which is effective for fiscal year 1992 and thereafter, are to:

[1]Terms included in Appendix C: Glossary are printed in CAPITAL LETTERS when they appear for the first time. (Note: See "Appendix E: Consolidated Glossary".)

- Require that, for each fiscal year in which the direct loans or the loan guarantees are to be obligated, committed, or disbursed, the President's budget reflect the long-term cost to the government of the subsidies associated with the direct loans and loan guarantees. The subsidy cost estimate for the President's budget is to be based on the PRESENT VALUE of specified cash flows discounted at the average rate of marketable Treasury securities of similar maturity.
- Require that, before direct loans are obligated or loan guarantees are committed, annual appropriations generally be enacted to cover these costs. (However, mandatory programs have permanent indefinite appropriations.)
- Provide for borrowing authority from Treasury to cover the non-subsidy portion of direct loans.
- Establish budgetary and financing control for each credit program through the use of three types of accounts: the PROGRAM ACCOUNT (budgetary), the FINANCING ACCOUNT (non-budgetary), and the LIQUIDATING ACCOUNT (budgetary).

The Need For Accounting Information

8. Accounting information on credit programs provides the basis for evaluating program performance by comparing actual accounting data with estimated budget data. Budget analysts and decision-makers can use accounting information to compare actual cash flows with projected cash flows and actual costs of direct loans and loan guarantees with their estimated costs.

9. For credit program managers, information on estimated default losses and related liabilities, when recognized in a timely manner, can be an important tool in evaluating credit program performance. The information can help determine a credit program's overall financial condition and identify its financing needs.

10. Furthermore, cost and performance information on loans and loan guarantees maintained by COHORT and RISK CATEGORY can highlight those groups that are not expected to meet budget estimates because of increased risk. Based on such information, program managers can take timely action to reduce costs, control risks where possible, and improve credit program performance.

Present Value Accounting

11. The Federal Credit Reform Act of 1990 requires that effective October 1, 1991, the cost of direct loans and loan guarantees be estimated at present value for the budget. The objectives of using the present value measurement in federal credit reform are to measure

recognize, and control subsidy costs of direct loans and loan guarantees.[2]

12. For direct loans, the effect of using the present value measurement is to estimate the extent of the disbursed amounts that would be recovered, and the extent of the disbursed amounts that is a subsidy cost. The portion that can be recovered is the present value of projected net cash inflows discounted at the Treasury rate of similar maturity. This portion is not considered a cost to the government because it is expected to be returned to the government in future amounts. The remaining portion of the cash disbursement represents a cost to the government, resulting either from lending at a rate lower than the Treasury interest rate, or from default losses, or both.

13. Under credit reform, the subsidy portion of direct loans is financed by appropriations, and the unsubsidized portion of the loans, which equals the present value of the government collections from the borrowers, is financed with funds borrowed from Treasury. The subsidy cost of loans must be REESTIMATED and updated annually.

14. The present value measurement basis is also applied to loan guarantees. Before credit reform, as in the case of direct loans, loan guarantees were measured for the budget on a cash basis. Thus, loan guarantees could appear to be virtually cost free, since cash payments by the government were not required unless and until the guaranteed loans defaulted at a future date. Under credit reform, the future cash outflows required by LOAN GUARANTEE COMMITMENTS must be projected and discounted at an appropriate Treasury interest rate. The present value of the cash outflows is the cost of the loan guarantees. Before loan guarantees are committed, annual appropriations generally must be enacted to cover the cost of the loan guarantees.

Financial Reporting

15. The Board believes that present value measurement should be adopted for financial accounting and reporting on direct loans and loan guarantees that have been or will be obligated or committed after September 30, 1991. Since the Act requires that the costs of these POST-1991 DIRECT LOANS AND LOAN GUARANTEES be estimated at present value for budget purposes, financial reports on actual results measured at present value can be used as feedback to compare with budget estimates. Such comparisons can be used as a basis to improve future estimates and REESTIMATES.

[2] Congressional Budget Office, “Credit Reform: Comparable Budget Costs for Cash and Credit” (Dec. 1989), p.33.

16. The Board recognizes that effective use of the present value accounting method depends on accurate projections of future cash flows over the life of direct or guaranteed loans. The efforts to make accurate projections should begin with establishing and using reliable records of historical credit performance data, and should take into consideration current and forecasted economic conditions.

17. 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. The Board is aware 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.

18. The Board considered the expected costs and efforts that would be required in restating PRE-1992 DIRECT LOANS AND LOAN GUARANTEES at present value. Based on this consideration, the standards permit but do not require restating those loans and loan guarantees on a present value basis.

19. The standards were proposed in an Exposure Draft issued in September 1992. Comments were received from 36 organizations and individuals. Oral comments were also presented at a meeting by representatives of federal agencies with major credit programs. The Board considered all the comments received and incorporated changes, as appropriate. Issues raised by those who responded to the Exposure Draft and the Board’s conclusions are presented in Appendix A, “Basis of the Board’s Conclusions.”

Effective Date

20. The FASAB recommends that the accounting standards recommended in this Statement become effective for fiscal years beginning after September 30, 1993. An earlier implementation is encouraged.

The Accounting Standards

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 similar maturity to the cash flows, applicable to the period during which the loans are 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 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.

27A. 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 27.

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 used to calculate the present value of the direct loans when the direct loans were disbursed, after adjusting for the interest rate re-estimate. The amortized amount is recognized as an increase or decrease in interest income.

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

32. Credit programs should re-estimate 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 re-estimates: (a) interest rate re-estimates, and (b) technical/default re-estimates.[2a] Entities should measure and disclose each program's re-estimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the re-estimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

(A) An interest rate re-estimate is a re-estimate 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 re-estimate for cohorts from which direct or guaranteed loans are disbursed during the 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 re-estimate for those cohorts should be made as of the date of the financial statements.

(B) A technical/default re-estimate is a re-estimate 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 re-estimates explained in (a) above. In making technical/default re-estimates, 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 re-estimate should be made each year as of the date of the financial statements.

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

[2a] The term "technical/default re-estimate" used in this statement is identical in meaning to the term "technical re-estimate" used in OMB Circular A-11, as revised in July 1999.

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; and (6) newly developed events that would affect the loans' performance. Improvements in methods to reestimate defaults are also considered.

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 data base 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 work-outs 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 VALUE[3] of the loans over their POST-MODIFICATION VALUE[4] The amount of the modification cost is recognized as a modification expense when the loans are modified.

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[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 cash flows of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[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 cash flows of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

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, after adjusting for the interest rate re-estimate).

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 TRANSFER[5] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

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 LIABILITY[6] of the loan guarantees over their PRE-MODIFICATION LIABILITY.[7] The modification cost is recognized as modification expense when the loan guarantees are modified.

[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.)

[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 cash flows 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 cash flows of the guaranteed loans under pre-modification terms (simply stated, the pre- modification terms at the current rate.)

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, after adjusting for the interest rate re-estimate).

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. Any difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer[8] 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

[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.)

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 transfer[10] 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. The U.S. government-wide financial statements need not include this disclosure.

Foreclosure of Post-1991 Direct Loans 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 adjusted for the interest rate re-estimate.

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 present value of the estimated 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 adjusted for the interest rate re-estimate.

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.

[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. 5 for an explanation of "modification adjustment transfer."

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.

[See SFFAS 18, par. 10 and 11 for additional disclosure requirements.]

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

Appendix A: Basis Of The Board's Conclusions

This appendix discusses the substantive comments that the Board received from respondents to the Exposure Draft, Accounting for Direct Loans and Loan Guarantees, issued in September 1992. The Appendix explains the Board's conclusions on issues raised by the respondents.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Present Value Accounting

62. Several respondents were opposed to using present value accounting for direct loans and loan guarantees. They pointed out that although the Federal Credit Reform Act of 1990 requires the use of present value to measure the subsidy costs of direct loans and loan guarantees for the budget, the law does not require using present value for financial reporting. They believed that since there are no legal requirements, the adoption of present value accounting should be based on cost-benefit considerations.

63. These respondents emphasized the complexity and cost of implementing and maintaining present value accounting. Because of the need to separately account for the direct loans or loan guarantees obligated or committed by each credit program in a fiscal year by cohort, as years go by, the number of cohorts would multiply. An agency with a number of loan and loan guarantee programs estimated that within 5 years, there would be more than 200 cohorts, one for each year and each program. Since most of its loans are long-term, maturing in 30 or more years, the number of cohorts would be staggering.

64. The respondents who were opposed to present value accounting doubted whether there would be any significant improvement in financial information on loans and loan guarantees reported on a present value basis compared with information traditionally reported on a nominal value basis. They contended that both present value accounting and nominal value accounting rely on historical experience and management judgment to evaluate risk as the primary variable in determining a default allowance. They further argued that since present value calculations involve cash flow estimates over future years, information based on the estimates is not necessarily more reliable than information reported under the nominal value accounting method.

65. A number of respondents expressed support of the Board's proposal to use present value accounting for direct loans and loan guarantees. They believed that it is a positive step to bring budgeting and financial reporting together. They also believed that implementation of the proposed standards would present useful information for monitoring programs with direct loans and loan guarantees.

66. In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 and to make financial reporting compatible with the budget. (See Exposure Draft, Vol. 1, par. 15.) The Board believes that one of the objectives of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget.[11]

67. The Federal Credit Reform Act of 1990 requires using present value for the budget. The Board does not believe that this requirement should be ignored for financial reporting. Since budgetary resources for direct loan and loan guarantee subsidies are provided on a present value basis, financial reporting on the acquisition, use, and status of the resources should be on the same basis. Only by using the same basis can financial information be used to compare the actual results with the budget.

68. Indeed, distortion in information would result if present value were not used to report direct loans or loan guarantees that are budgeted on a present value basis. This can be illustrated by the following example.

69. Suppose a group of 5-year term loans in the aggregate amount of $100,000 were disbursed by a federal credit program at the end of fiscal year 1992. The loans require paying an annual interest of 5 percent and repaying the principal in fiscal year 1997. It was estimated that the interest would be collected each year, but only $80,000 of the principal would be repaid when the loans mature. During the year the loans were disbursed, the average interest rate of Treasury securities of the same maturity was 9 percent.

70. Based on the cash flow projection shown in Table 1 below, at the end of the 1992 fiscal year, the present value of the direct loans was $71,440 and the loans' subsidy cost was $28,560. It is assumed in this example, that as required by credit reform, the subsidy cost ($28,560) was funded with appropriations, and the remaining amount ($71,440) was financed with borrowing from Treasury at 9 percent.

[11]FASAB Exposure Draft, Objectives of Federal Financial Reporting, Vol. 1, par. 13.

Table 1: The Present Value Of Direct Loans

Fiscal Years	Expected Payments
1993	$5,000
1994	5,000
1995	5,000
1996	5,000
1997	$85,000
Present value at 9%	**$71,400**

71. If the nominal value accounting method were used in financial reporting, the $20,000 of the principal that was estimated to be uncollectible would have been reported as a bad debt expense. The estimated uncollectible amount of $20,000 would have been recognized as the cost of the loans in financial statements. In reality, however, the agency spent $28,560 of budgetary resources to fund the cost of the loans.

72. Also, if the nominal value accounting method were used, the loans as assets would have been reported at $80,000 at the end of the 1992 fiscal year, which equals the $100,000 principal of the loans minus an allowance of $20,000 for the uncollectible amount. On the other hand, debt to Treasury would have been reported at $71,440, which was the amount actually borrowed to finance the loans. The financial information would have shown an excess of the assets over the liability by $8,560. In reality, however, even if the default estimate was correct, the entire collection of interest and principal would be used to pay interest and principal to Treasury. The credit program in fact would have no excess in assets. The following is a comparison of the loans reported on a present value basis and on a nominal value basis.[12]

[12]Tables are provided only for illustration. They do not represent a reporting format.

Table 2: Reporting On The Direct Loans At Present Value On September 30, 1992

Assets		Liabilities	
Loans receivable	$100,000	Debt to Treasury	$71,440
Subsidy cost allowance (28,560)	(28,560)		
Loans receivable, net	$ 71,440		
		Net Position	**$0**

Table 3: Reporting On The Direct Loans At Nominal Value On September 30, 1992

Assets		Liabilities	
Loans receivable	$100,000	Debt to Treasury	$71,440
Subsidy cost allowance (28,560)	(20,000)		
Loans receivable, net	$ 80,000		
		Net Position	**$8,560**

73. A similar distortion would result in reporting loan guarantees. The distortion would be caused by reporting loan guarantee liabilities on a nominal value basis, whereas the budgetary resources received to finance the liabilities are measured at a present value basis.

74. In evaluating efforts and costs of implementing present value accounting for post-1991 direct loans and loan guarantees, one should keep in mind that the federal direct loan and loan guarantee programs have modified or will have to modify their accounting systems in order to implement the budgeting requirements of the Federal Credit Reform Act of 1990. They will have to maintain data by cohort and risk category, compute interest on borrowing from Treasury and on uninvested funds, and make subsidy estimates and reestimates. The accounting standards provided in this statement do not require more than the budget process requires in these respects, and thus they would not result in a substantial amount of additional effort or cost.

75. Some respondents indicated that it would be burdensome if present value accounting were to be implemented on a loan-by-loan (or transaction) basis. The Board does not propose that the accounting standards be implemented on a loan-by-loan basis. The standards

should apply to a cohort (or risk category) of direct loans or loan guarantees in the aggregate.

76. In addition to making financial reporting consonant with the budget, the Board also believes that the standards proposed in the Exposure Draft will produce better financial information for the following reasons:

77. First, the proposed standards would require measuring and recognizing the subsidy costs of direct loans and loan guarantees at their inception rather than at a later date. The current accounting practice does not require this. In the absence of this requirement, the cost of direct loans is not recognized when the loans are disbursed, and the liability to pay claims under loan guarantees is not usually recognized when guaranteed loans are disbursed.

78. Second, the proposed standards would require a comprehensive evaluation of future cash flows over the life of direct loans and guaranteed loans, including payments of interest, principal, fees, prepayments, defaults, delinquencies, and recoveries. The current accounting practice typically provides an allowance for the portion of the principal that would not be collected. It does not take into account the impact of other cash flow elements.

79. Third, the proposed standards would require discounting the net cash flows at the government's borrowing rate on marketable Treasury securities. Discounting is a basic feature of present value accounting that measures and recognizes the interest subsidy cost of direct loans and loan guarantees, and the time value of all cash flows. The time value of such cash flows is not accounted for under the nominal value accounting method, and the interest subsidy cost is not accounted for when the loans are disbursed.

80. Finally, the proposed standards would require an annual systematic review of the projected cash flows. The projections would be revised and updated to reflect newly developed events, changes in economic conditions, and better understanding of the factors that cause defaults. The subsidy costs would be reestimated accordingly. The reestimation requirement assures that credit programs maintain an up-to-date data base by cohort and risk category of actual collections, defaults, and amounts written off on federal loans and loan guarantees. Such a complete data base was not available prior to credit reform.

81. In summary, the recognition of cost at inception, the comprehensive evaluation of all future cash flows, and the discounting of future cash flows to present value are complementary elements at the core of present value accounting. When taken together, they place an economic value on the cost the federal government incurs in making direct loans and loan guarantees. Likewise, they place an economic value rather than a nominal value on loan assets and loan guarantee liabilities.

82. Based on the view that financial accounting should be compatible with the budget, and based on the other advantages of using the present value accounting, the Board has concluded that the present value accounting method should be used in the accounting standards for post-1991 direct loans and loan guarantees.

Subsidy Cost Component

83. The Exposure Draft proposed that when direct or guaranteed loans are disbursed, their subsidy expense be recognized separately among interest subsidy costs, default costs, fees (as a deduction from the costs), and other subsidy costs.

84. The Exposure Draft also proposed the following requirement: The interest subsidy allowance shall be amortized using the interest method. Compound interest shall be accumulated on the allowances for default losses, fees, and other cost components.

85. The Exposure Draft posed a question: Should the subsidy cost components, if material, be recognized separately in financial reporting? Some respondents agreed that the subsidy cost components should be separately recognized. They believed that separate recognition would provide the level of detail needed to understand the program better and improve their component estimates for budget formulation.

86. Some respondents were opposed to reporting subsidy costs by component on the grounds that (1) only the aggregate amount of subsidy costs is needed for budget execution purposes, (2) information on cost components may not be used by management, and (3) the cost of complex record-keeping and calculations outweigh the benefit.

87. After considering the benefits and efforts required in accounting for subsidy cost components, the Board has concluded that when direct or guaranteed loans are disbursed, the subsidy expense of the direct loans or loan guarantees should be recognized in separate components. The Board believes that by reporting the subsidy expense components of direct or guaranteed loans disbursed during the reporting year, the cost components of newly disbursed direct loans and loan guarantees can be compared with those of prior years. The cost component information would be valuable for making credit policy decisions, monitoring portfolio quality, and improving credit performance. Information on interest subsidies and fees would help in making decisions on setting interest rates and fee levels. Information on default costs would help in evaluating credit performance.

88. In calculating the present value of the subsidy costs for the budget, agencies must first develop data on cash flow components. OMB requires agencies to use the OMB credit subsidy model, which takes these cash flows as inputs and automatically calculates the components of the subsidy cost. Since the information on subsidy cost components of new

direct loans and loan guarantees is available, reporting the information would not require significant additional efforts.

89. However, the Board realizes that it would require considerable efforts to maintain records for the present value of cost components for each existing cohort of loans and loan guarantees, amortize or accumulate interest on each component each year, adjust each component each year for reestimates, and, if applicable, adjust each component for modifications when they occur. After considering the efforts that would be required and the benefits that could be derived, the Board decided not to recommend the requirement to amortize or accumulate interest on each subsidy cost component. Without this requirement, credit programs may amortize the subsidy allowance of each cohort in aggregate, using the interest method. They would not have to maintain records for the present value of each cost component and adjust them annually. This would greatly ease the record-keeping and calculation burden.

90. By eliminating the requirement to amortize and accumulate interest on each component of the subsidy cost allowance, the Board realizes that information would not be available to track changes in the present values of the components. However, data would still be available to track changes in the total amount of a cohort's subsidy allowance affected by annual reestimates. The primary factor that causes changes in the subsidy allowance would be default reestimates. Furthermore, the Board believes that it is of a critical importance that each credit program maintain a data base for actual collections, defaults, delinquencies, and recoveries. For purposes of monitoring program performance and estimating future losses, the actual default and collection data base is more important than tracking changes in the allowance for the present value of subsidy costs by component. The actual default and collection data base is also necessary for estimating and reestimating subsidy costs.

Accounting For Fees

91. In the Exposure Draft, the Board proposed that the present value of estimated fee receipts be recognized as a deduction from the subsidy expense. The Board posed a question: How should fees be recognized on an entity's financial reports? Should they be recognized as a deduction of subsidy expense, or as a revenue?

92. Many respondents agreed with the proposal that the present value of estimated fee collections be recognized as a deduction of subsidy expense. Some respondents contended that fees should be recognized as a revenue rather than as an expense component. They stated that offsetting revenues against expenses would not provide clear revenue/expense information concerning the operating results of a credit program. Some of the respondents also said that to the extent some of the fees are used to defray administrative costs, they should not offset subsidy expenses because the Federal Credit Reform Act of 1990 excludes administrative costs from subsidy expenses.

93. The Board is not persuaded by the arguments that fees should be reported as a revenue. The subsidy expense of direct loans and loan guarantees is the focal point of credit reform, and it is measured as the present value of the net cash flows of the direct loans and loan guarantees. Since the estimated fees are a component of the cash flows, the Board believes that the present value of fees should be reported as a component of the subsidy expense. Since the Board has concluded that all of the subsidy expense components, including the present value of fees, are to be reported separately, reporting the present value of fees as an expense component would not reduce information on the collection of fees. Furthermore, the administrative expenses that are excluded from subsidy costs are often covered by appropriations, rather than paid by fee collections. Thus, it is not necessary to allocate a portion of the fee collections to pay the administrative costs that are not a part of the subsidy costs.

Pre-1992 Direct Loans And Loan Guarantees

94. The phrase pre-1992 direct loans and loan guarantees refers to direct loans obligated and loan guarantees committed before October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. In the Exposure Draft, the Board did not recommend restating pre-1992 direct loans and loan guarantees at present value. The Board's position was that the costs of restating those direct loans and loan guarantees would outweigh the benefits.

95. Most respondents who commented on this issue agreed with the Board's position. They emphasized that the restatement of pre-1992 direct loans and loan guarantees would be a complex process and would require substantial resources. They pointed out that a major difficulty is caused by the lack of complete and accurate historical data that a restatement needs to be based upon. Because of the lack of accurate data, even if the agencies incurred a great deal of cost, the restated loans and loan guarantees could not be accurately compared with post-1991 loans and loan guarantees on the same basis. The respondents pointed out that since the pre-1992 direct loans and loan guarantees were obligated or committed in the past, restated information would be of limited usefulness to current budget decisions. They also pointed out that the amount of pre-1992 direct loans and loan guarantees outstanding would diminish over time as loans matured, defaulted, or were modified.

96. In addition to considering the comments on the Exposure Draft, the Board also considered the findings of a GAO report presented to the Board.[13] The GAO report suggested that by not requiring a restatement of pre-1992 direct loans and loan guarantees at present value,

[13] *GAO Report to the Chairman, Senate Budget Committee, Federal Credit Programs: Agencies Had Serious Problems Meeting Credit Reform Accounting Requirements* (GAO/AFMD-93-17, Jan. 1993).

poor information would be perpetuated, which could affect the ability to (1) forecast the future budgetary impact of pre-credit reform credit activity, (2) minimize losses, and (3) judge the reasonable accuracy of subsidy estimates for post-1991 credit. The GAO report recommended using simplified methods, such as sampling techniques, to restate pre-1992 direct loans and loan guarantees at present value.

97. However, there was a strong indication in the comments the Board received and in the findings of the GAO report that agencies have been experiencing serious difficulties in implementing the credit reform requirements related to post-1991 direct loans and loan guarantees. A restatement of pre-1992 direct loans and loan guarantees, even on a sampling basis, would require additional use of the agencies' limited accounting resources. The Board also agrees with the view that as the pre-1992 direct and guaranteed loans are approaching their maturity and are paid off, liquidated, or written off, the difference between their present value and nominal value becomes less significant. Thus, the Board concludes that it is appropriate not to require restating pre-1992 direct loans and loan guarantees at present value.

98. The Department of Veterans Affairs stated in its comments that it had accounted for pre-1992 loan guarantees on a present value basis. The Department of Education indicated in its comments that it planned to report pre-1992 loans on a present value basis. Their efforts to account for pre-1992 loans and loan guarantees at present value, although not at the same level of detail as required by credit reform, could very well result in improved information for credit management. Other agencies may follow their examples. The Board believes that reporting those pre-1992 direct loans and loan guarantees on a present value basis should be permitted.

99. Although a restatement of pre-1992 direct loans and loan guarantees at present value is not required, the Board continues to believe that it is of fundamental importance to estimate and recognize losses and liabilities for those direct loans and loan guarantees. Loss estimation and recognition are necessary to support federal government financial planning and management. The information on both current and potential liabilities related to federal credit programs alerts Congress and federal officials to the long-term costs and future financing needs.

100. The recommended standards would require that losses of pre-1992 direct loans and liabilities related to pre-1992 loan guarantees be recognized when it is more likely than not that the loans will not be totally collected or the loan guarantees will require a future cash outflow to pay default claims. This is the same standard that the Board recommended for the recognition of losses on receivables in FASAB Statement of Recommended Accounting Standards No. 1, Accounting for Selected Assets and Liabilities.

101. The Board believes that each loan guarantee program should disclose the aggregate amount of outstanding guaranteed loans. In addition, it should also disclose its risk exposure, which is the guaranteed portion of the total outstanding guaranteed loans.

Modifications

102. A modification is a government action that alters the estimated subsidy cost of outstanding direct loans or loan guarantees. Both a government action and an alteration in subsidy cost are necessary conditions for a modification. A subsidy reestimate is not a modification.

103. Direct modifications change the subsidy cost by legislation or administrative actions that alter the terms of existing contracts or by selling loan assets. Existing contracts may be altered by such means as forgiveness, forbearance, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered workouts as explained below or are permitted by the existing contract terms.

104. Indirect modifications 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. Such new legislation would produce a one-time effect on the subsidy cost of outstanding direct loans and loan guarantees only. After the enactment of the legislation, the effects of the legislation are included in the original subsidy cost estimates of newly obligated direct loans and newly committed loan guarantees. Thus, the legislation is not a modification with respect to direct loans obligated and loan guarantees committed subsequent to its enactment.

105. The term “modification” does not include the routine administrative work-outs of troubled loans or loans in imminent default. Work-outs are actions undertaken to maximize the repayments to the government under existing direct loans or to minimize claim payments that the government would make under loan guarantees. The expected effects of work-outs on cash flows are included in the original estimate and the reestimates of the subsidy cost. Therefore, a workout effort is not a government action that alters the estimated subsidy cost of direct loans or loan guarantees.

106. The term “modification” also does not include actions that are permitted within the existing contract terms, such as prepayments without penalty permitted by existing loan contracts. The expected effects of such actions on cash flows are included in the original estimate and the reestimates of the subsidy cost.

107. Neither the term “modification” nor the term “workout” includes additional disbursements to borrowers that increase the amount of direct loans outstanding. These disbursements are considered to be new loans in the amount of the increment.

108. When direct loans and loan guarantees are modified, the subsidy cost of the modification must be calculated. The book value of the modified loans and the liabilities of the modified loan guarantees must be restated. The Exposure Draft used two types of discount rates to calculate the present values of post-1991 direct loans and loan guarantees that are modified: CURRENT DISCOUNT RATES and original discount rates.

109. The term “current discount rate” refers to 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 or guaranteed loans, under either pre-modification terms, or post-modification terms, whichever is appropriate. The cost of modification is measured as the excess of the present value of pre-modification net cash flows over the present value of post-modification cash flows, both discounted at a current discount rate. This is consistent with the measurement method described in OMB instructions.

110. The term “original discount rate” refers to the discount rate that is originally used to calculate the present value of the direct loans or the present value of loan guarantee liabilities, when the direct or guaranteed loans were disbursed. The value of modified loans or the liability of modified loan guarantees equals the present value of modified cash flows discounted at the original discount rate. The original discount rate is used to determine the value of modified loans because this is the interest rate that the Treasury charges on funds that it lends to the credit program to finance the loans. The original discount rate is also used to determine the liability of modified loan guarantees because this is the interest rate that the Treasury pays on funds that it holds for the credit program to pay future claims.

111. Because of using the two different rates, a difference will normally occur between the change in the book value of modified direct loans and the cost of the modification. In the case of loan guarantees, there will normally also be a difference between the change in the liability of modified loan guarantees and the cost of modification.

112. The Exposure Draft used an example to illustrate the difference.[14] The example used the original discount rate of 6 percent to calculate the book value of a modified loan, and it used the current discount rate of 8 percent to calculate the cost of modification. The calculations resulted in a difference between the change in book value and the cost of modification.

[14]See Exposure Draft, Vol. 2, pars. 221 through 231, and Appendix 2, pages 139 through 143.

113. OMB instructions require that an amount equal to the difference between the change in book value and the cost of modification either be returned to, or received from, the Treasury to offset the difference. The amount transferred to offset the difference is referred to in OMB instructions as the modification adjustment transfer. This transfer does not constitute a part of the cost of modification and is not a budget outlay or collection.

114. Several respondents objected to use of the current rate for measuring the modification cost. They believed that both the modification cost and the value of the modified loans (or the liability of modified loan guarantees) should be measured on the same basis, using the original discount rate. They said that by using the original discount rate for measuring both the cost and the book value or the liability, there would be no difference between the modification cost and change in book value (or change in loan guarantee liability). They argued that the additional computations at current discount rate do not result in any additional meaningful information for use by management. They contended that the complexity of the computation, the effect of changing discount rates, and the resulting difference between the change in book value and the cost of modification would only detract from management's ability to analyze the results of modification.

115. The Board realizes that it is undesirable to calculate the cost of modification and change in book value on different bases. Because the cost of modification and the book value are calculated on different bases, the modification expense recognized would not equal the decrease in the book value of direct loans (or the increase in the liability of loan guarantees) resulting from the modification.

116. However, it is also undesirable to recognize a modification expense at a measurement basis that differs from the budget and appropriation basis. The OMB instructions concerning the definition and the cost of modification have carried a great weight on the Board's consideration of the subject. The OMB instructions require that the cost of modification be measured at the current rate, and appropriations approved for a modification will equal the cost of modification. The Board believes that financial reporting should reflect the modification cost recognized in the budget and the modification appropriations received.

117. The Board also appreciates the rationale in OMB instructions. The Federal Credit Reform Act of 1990 requires that the calculation of modification cost be based on the estimated present value of the direct loans or loan guarantees at the time of modification. This requirement has been interpreted as calculating the present value of modification cost at the discount rate applicable at the time of modification. The Board also agrees with the substantive rationale for using the current rate. By using the current rate, the calculation of the modification cost will reflect the economic cost of the modification at the time when the modification decision is made.

118. The Board found that some of the opposition to the use of the current rate for modifications arose because of a misunderstanding about the difference between modifications and work-outs. Once the distinction was clarified between work-outs (which are included in the initial subsidy estimates and are quantified using the original rates) and modifications (which require separate action as described, but are less frequent in occurrence), much of the opposition to using current rates for modifications disappeared.

119. In considering a solution for the measurement difference between the modification cost and the book value of the loan (or the loan guarantee liability), the Board has considered as an alternative whether the current rate could also be used to calculate the value of modified direct loans (or the liability of modified loan guarantees) so that the change in direct loan book value or loan guarantee liability could equal the cost of modification. The Board has decided against this for the two reasons explained below.

120. First, under credit reform, the un-subsidized portion of direct loans is financed by funds borrowed from Treasury, while the subsidy cost of the direct loans is financed by appropriations. Thus, the carrying amount of direct loans at any point should equal the balance of debt to Treasury. Proceeds from collecting direct loan principal and interest will be used to repay debt to Treasury. This exact match between loan assets and liabilities (debt to Treasury) is a unique feature that makes credit reform loans and loan guarantees different from private sector lending.

121. When a modification occurs, the book value of the direct loans is affected. An amount of modification appropriation, plus or minus the modification adjustment transfer, would be used to reduce the debt to Treasury. By doing so, the book value of the modified loans and the balance of the debt to Treasury would continue to be equal. It is important to note that the interest rate on the debt to Treasury does not change as a result of the modification; it remains the original rate. Thus, the debt balance to Treasury in fact equals the present value of future payments to Treasury discounted at the original rate. Since the debt to Treasury is based on the original rate, that rate should also be used to calculate the book value of modified loans, so that the book value of the loans and the balance of debt to Treasury would be kept equal.

122. A parallel situation exists with loan guarantees. The financing account of each loan guarantee program maintains a fund balance with the Treasury equal to the liability of the loan guarantees. The fund balance and the liability grow at the same compound interest rate. The fund balance will accrue interest at the original rate applicable at the time the guaranteed loans were disbursed. The interest rate will not change because of a modification of the loan guarantees. Thus, only by measuring the liability of the modified loan guarantees at the original rate could the liability be kept equal to the fund balance.

123. Second, even if the current rate were used to calculate the book value of modified loans, the difference between the change in book value (or the change in liability balance) and the modification cost would not disappear. In measuring the change in book value (or the change in liability balance), the starting point is the pre-modification book value (or the pre-modification liability balance), which is based on the original discount rate. If the current rate is used to calculate the post-modification book value of modified direct loans, the change in book value would equal the difference between the pre-modification book value (based on the original rate) and the post-modification book value (based on the current rate). Similarly, if the current rate is used to calculate the post-modification balance of modified loan guarantee liabilities, the change in liability balance would equal the difference between the pre-modification balance (based on the original rate) and the post-modification balance (based on the current rate).

124. The cost of modification, on the other hand, is calculated differently. The starting point of the calculation is not the existing pre-modification book value of the modified loans (or the existing pre-modification book value of the liability of the modified loan guarantees). For both direct loans and loan guarantees, the calculation uses the present value of pre-modification net cash flows discounted at the current discount rate as the starting point. This pre-modification value differs from the existing pre-modification book value because the latter is based on the original discount rate. The cost of modification equals the difference between the present value of pre-modification net cash flows (discounted at the current rate) and the present value of post-modification net cash flows (also discounted at the current rate). Since the calculations take a different starting point, the cost of modification would not equal the change in book value.

125. Because of the two reasons above, the Board believes that the best solution available is to measure the cost of modification at the current discount rate, and to calculate the carrying amount of modified loans and loan guarantee liabilities at the original discount rate.

126. However, while it makes sense to determine the cost of modification based on the current discount rate, financial reporting cannot discard the pre-modification balance of direct loans or loan guarantee liabilities that are carried in the accounting records. Because of the use of different discount rates, the change in book value will be different from the cost of modification. The Board believes that the effect of a modification on assets or liabilities should be reflected in the operating statement. The Board believes that in addition to recognizing the cost of modification as a modification expense, any difference between the change in book value and the modification expense should be recognized as a gain or loss. Thus, the net effect of the modification on the operating statement equals the decrease in loan assets or the increase in the liability of loan guarantees resulting from the modification.

127. Based on this view, the Board has concluded that, with respect to a modification of direct loans, any difference between the change in the book value of the direct loans resulting

from the modification and the cost of modification should be recognized as a gain or loss in the operating statement. Similarly, any difference between the change in the amount of liability of loan guarantees resulting from the modification and the cost of modification should be recognized as a gain or loss in the operating statement. The gain or loss is to be recognized in a category distinguished from the modification expense. The modification adjustment transfer paid or received to offset the gain or loss is to be reported as a financing source or a reduction in financing source.

128. The Board further believes that agency financial statements should include a footnote to explain the calculation of the cost of modifications and nature of gain or loss on modifications.

Appendix B: Technical Explanations And Illustrations

This Appendix explains and illustrates the accounting standards for direct loans and loan guarantees. The explanations and illustrations are presented to show how the standards may be applied but are not standards themselves. They also take into account OMB and Treasury regulations on credit reform.

This Appendix has 4 parts:

- Part I: Post-1991 Direct Loans
- Part II: Pre-1992 Direct Loans
- Part III: Post-1991 Loan Guarantees
- Part IV: Pre-1992 Loan Guarantees

Topics covered include:

- the measurement and recognition of direct loans, subsidy costs, and the liability of loan guarantees;
- the reestimation and the amortization of the subsidy cost allowance;
- the reestimation of loan guarantee liabilities and the accumulation of interest on the liabilities;
- the recognition of revenues and expenses;
- modifications of direct loans and loan guarantees (including the sale of direct loans);
- the write-off of direct loans; and
- the foreclosure of assets upon default.

The Appendix does not illustrate financial statements, journal entries, or accounting procedures. Readers should consult OMB, GAO, and Treasury for guidance.

Part I: Post-1991 Direct Loans

Post-1991 direct loans are direct loans obligated after September 30, 1991. The accounting for post-1991 direct loans is explained and illustrated in this part of the Appendix through an example described below:

At the end of fiscal year 1994, a federal credit program disburses a number of direct loans with a total principal of $10 million. Those loans constitute a cohort for that year. The maturity term of that cohort is 5 years and the stated annual interest rate is 4 percent.

All of the amounts used in the text below are in thousands of dollars.

The loan contracts require an annual payment of $2,246 per year for 5 years, paid at the end of each year. In Table 1 below, the required annual payments are shown in column (a).[15] The amounts in column (b) equal the beginning loan balance of each period multiplied by the stated interest rate of 4 percent. The amounts in column (c) are principal repayments, which equal the amounts in column (a) minus the amounts in column (b). The amounts in column (d) are the ending principal balance of each period, which equal the beginning balance minus the principal repayment of that period, shown in column (c).

Table 1: Payment Schedule (in thousands of dollars)

FY	Payment (a)	Interest (b)	Principal (c)	Year-End Loan Balance (d)
1994				$10,000
1995	$2,246	$400	$1,846	8,154
1996	2,246	326	1,920	6,234
1997	2,246	249	1,997	4,237
1998	2,246	169	2,077	2,160
1999	2,246	86	2,160	0

It is also assumed that:

- The average interest rate of Treasury marketable securities of a similar maturity for the period during which the loans are disbursed is 6 percent.
- Fees totaling $500 are received when the loans are disbursed. The fees are used to reduce the need to borrow from Treasury.

A. Reporting Post-1991 Direct Loans And Their Subsidy Costs

The accounting standard for post-1991 direct loans requires that direct loans disbursed and outstanding be 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.[16]

[15]The annual payment is derived by dividing the present value factor of 4.45182 into the principal of $10,000. The present value factor can be found in any ordinary annuity table, and it equals the present value of $1 paid over 5 periods discounted at 4 percent. Alternatively, knowing the loan principal, the number of pay back periods, and the interest rate, one can use computer software or a financial calculator to find the required payment per period.

[16]In this Appendix, the requirements of the accounting standards are summarized to address specific situations. However, the standards are not quoted verbatim. Readers should refer to the text of the standards for their exact wording.

To implement the standard in the example, a cash flow projection and present value calculations are prepared. Based upon the risk factors and other criteria for default cost estimates that are enumerated in the accounting standards, it is estimated that losses in cash flows due to the defaults would equal 30 percent of the scheduled payments for fiscal year 1997 and each year thereafter.[17] Table 2 below displays the cash flow projections and present value calculations.

Table 2: Projected Cash Flows Discounted To The End Of FY 1994 (in thousands of dollars)

FY	Fee Collections	P & I Payments[a]	Default Losses	Net Cash Inflows
1994	$500			$500
1995		$2,246		2,246
1996		2,246		2,246
1997		2,246	$(674)	1,572
1998		2,246	(674)	1,572
1999		2,246	(674)	1,572
PV at 6%	$500	$9,461	$(1,603)	$8,358

[a]The term “P & I Payments” used in this table as well as other tables throughout this Appendix denotes scheduled principal and interest payments required in loan contracts.

The present value of the loans’ estimated net cash inflows is $8,358. The direct loans are recognized as assets at that amount. Since the loans’ outstanding principal is $10,000, the difference between the loans’ outstanding principal and their present value is $1,642, which is recognized as the subsidy cost allowance.

The accounting standard for post-1991 direct loans requires that for direct loans disbursed during a fiscal year, a subsidy expense be 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 disbursed (hereinafter referred to as the applicable Treasury interest rate).

[17]The standard defines losses in cash flows due to default as being due to defaults net of recoveries. However, to simplify computations, recoveries are assumed to be zero throughout Parts I and II of this Appendix. References to defaults throughout Parts I and II should be understood to mean defaults net of recoveries for all cases where recoveries are expected. The accounting standard for recoveries is illustrated in Part III of this Appendix.

In the example, the present value of the loans' cash outflows is the disbursed amount of $10,000. The present value of the loans' estimated net cash inflows is $8,358. The difference between those two amounts is $1,642, which is recognized as subsidy expense.

The accounting standard for post-1991 direct loans requires that for the fiscal year during which new direct loans are disbursed, the components of the subsidy expense of those new direct loans be recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

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 interest rate (6 percent in this example). In this example, the amount of the loans disbursed is $10,000. The present value of the scheduled interest and principal payments is $9,461. The difference between those two amounts is $539, which is recognized as the interest subsidy cost.

The default cost of direct loans results from any anticipated deviation, other than prepayments, by the borrowers from the payment schedules 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. (See footnote 3.) In this example, the present value of the projected payment omissions minus net recoveries is $1,603, which is recognized as the default cost.

The present value of fee collections is $500, which is recognized as a deduction from subsidy costs.

There are no other subsidy costs[18] in this example.

The subsidy expense of the loans is the sum of the above cost components, which is $1,642, calculated as follows:

Interest subsidy cost	$ 539
Fee collections	(500)
Loan default cost	1,603
Total subsidy cost	**$1,642**

The loan disbursements are financed by three sources: subsidy payments, borrowing from Treasury, and fee collections. The subsidy cost of $1,642 is provided by appropriated funds; and

[18]The term "other subsidy costs" is explained in the standard for subsidy costs of post-1991 direct loans and loan guarantees.

the present value of loans, equal to $8,358, is provided by fee collections and funds borrowed from Treasury at the Treasury interest rate of 6 percent.

The fees are collected when the loans are disbursed. Because all cash flows, including fee collections, are used to calculate the subsidy cost allowance, the amount of the fee collections is credited to the subsidy cost allowance. The collected amount reduces the amount that has to be borrowed from the Treasury. As a result, the subsidy cost allowance is $2,142, which is the sum of the interest subsidy cost of $539 and the default subsidy cost of $1,603. This is $500 more than the total subsidy cost of $1,642. The debt to Treasury is $7,858, which is $500 less than the present value of the loans of $8,358.

Table 3 displays the asset and liability balances at the end of fiscal year 1994.

Table 3: Assets And Liabilities As Of The End Of FY 1994 (in thousands of dollars)

Assets		Liabilities	
Loans receivable	$10,000	Debt to Treasury	$7,858
Less:			
Allowance for subsidy costs	(2,142)		
Loans receivable, Net	$7,858		

B. Subsidy Reestimation And Amortization

(1) Subsidy Reestimation

The accounting standard for post-1991 direct loans requires that the subsidy cost allowance for direct loans be reestimated each year as of the date of the financial statements. Since the allowance represents the present value of the net cash outflows of the underlying direct loans, the reestimation takes 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 resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).

The standard further states that reporting the subsidy cost allowance of direct loans and reestimates by component is not required.

In Appendix A, the Basis of the Board’s Conclusions, it is pointed out that the primary factor that causes changes in the subsidy cost allowance would be default reestimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and reestimates.

In this illustration, it is originally estimated that 30 percent of the loan payments would be lost due to defaults for fiscal year 1997 and thereafter. The first reestimate is made early in fiscal year 1995. Because so little time has passed since the subsidy was initially estimated, the estimated cash flows are unchanged and the reestimate is zero. (This illustration assumes that the interest rates at the time of loan obligation and disbursement are the same, so no reestimate is needed for the difference in interest rates.)

The second reestimation is performed early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It reestimates the subsidy cost allowance as of the end of fiscal year 1994. After evaluating all of the risk factors, it is concluded that defaults would occur in fiscal year 1996, instead of 1997, and that 60 percent, instead of 30 percent, of the cash flows would be lost due to the defaults in fiscal year 1996 and thereafter. Table 4 below displays the present values of the reestimated cash flows discounted to the end of fiscal year 1994.

Table 4: Subsidy Cost Reestimation: Projected Cash Flows Discounted To The End Of FY 1994 (in thousands of dollars)

FY	P & I Payments	Default Losses	Net Cash Flows
1995	$2,246	$0	$2,246
1996	2,246	(1,348)	898
1997	2,246	(1,348)	898
1998	2,246	(1,348)	898
1999	2,246	(1,348)	898
PV at 6%	$9,461	$(4,405)	$5,056

The present value of the reestimated net cash inflows discounted to the end of fiscal year 1994 is $5,056, compared to the loans' book value of $7,858, a decrease of $2,802. Thus, the subsidy cost allowance is increased by $2,802, from $2,142 to $4,944. The amount of the increase in the subsidy cost allowance (which is the decrease in the present value of the loans), resulting from the reestimate, is recognized as subsidy expense reestimates.

A subsidy payment of $2,802, equal to the subsidy expense resulting from the reestimate, is received under permanent indefinite authority. The amount is used to repay borrowing from Treasury. Thus, the outstanding balance of the debt to Treasury is reduced by $2,802 to $5,056.

Furthermore, the direct loan program also receives a payment under permanent indefinite authority to cover the interest accrued on the reestimate subsidy payment of $2,802 for the period from the end of fiscal year 1994 to the end of fiscal year 1995. The payment is $168, which equals $2,802 times the applicable Treasury interest rate of 6 percent. This amount is recognized as interest income reestimates, and the money is used to pay the interest on the $2,802 borrowed from Treasury but repaid with the reestimate subsidy.

Table 5 displays the asset and liability balances as of the end of fiscal year 1994, adjusted for the reestimate that was calculated early in fiscal year 1996.

Table 5: Assets And Liabilities As Of The End Of FY 1994: Amounts Adjusted For Reestimate Calculated In Early FY 1996 (in thousands of dollars)

Assets		Liabilities	
Loans receivable	$10,000	Debt to Treasury	$5,056
Less:			
Allowance for subsidy cost	(4,944)		
Loans Receivable, Net	$5,056		

(2) Subsidy Amortization

The accounting standard for post-1991 direct loans requires that the subsidy cost allowance for direct loans be 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.

The subsidy cost allowance is amortized as a whole, not by components. Under the interest method of amortization, the amortization of each period equals the effective interest of the outstanding direct loans minus the nominal interest. For any period for which interest is to be paid (a fiscal year in this example), the effective interest equals the book value (which is also the present value) of the direct loans at the beginning of the period times the applicable Treasury rate. The nominal interest equals the outstanding nominal balance of the loans at the beginning of the period times the interest rate stated in the loan contracts.

In the example, the book value of the direct loans, as reestimated, is $5,056. The effective interest for fiscal year 1995 is $303, which equals the book value of $5,056 times the applicable Treasury rate of 6 percent. The nominal interest for that year is $400, which equals the nominal principal of the direct loans $(10,000) times the stated rate of 4 percent. The amortized amount is a negative amount of $97 for fiscal year 1995, which equals the effective interest minus the nominal interest. The subsidy cost allowance is increased by $97, from $4,944 to $5,041. The amortized amount is recognized as a reduction in interest income. (Interest income for fiscal year 1995 is calculated in section C: Revenues and Expenses.)[19]

The same procedure of amortization is applied for each of the subsequent years so long as the direct loans are outstanding. The collection of interest and principal payments must be properly accounted for together with the amortization, so that the asset and liability balances can be updated.

At the end of fiscal year 1995, payments of $2,246 are received from the borrowers as scheduled. Of this amount, $400 is interest payments, and the remaining amount of $1,846 is principal repayments. Thus, the outstanding nominal balance of the loans is reduced by $1,846 to $8,154.

The $2,246 received from the borrowers was paid to Treasury. Although the debt to Treasury outstanding at the end of fiscal year 1994 was $7,858, the amount of $2,802 has been paid off by the subsidy payment for the reestimate. This left $5,056 of debt to Treasury. The interest that accrued on this remaining debt to Treasury is $303; the interest that accrued on the amount of debt paid off by the subsidy reestimate is $168, but it is covered by the interest on the reestimate. Therefore, of the $2,246 collected from the borrowers, $303 is interest paid to Treasury. The remaining $1,943 is principal repayment to Treasury. After the principal repayment, the outstanding debt to Treasury becomes $3,113.

Table 6 below displays the asset and liability balances after the amortization and the collection of interest and principal payments at the end of fiscal year 1995.

Table 6: Assets And Liabilities After Amortization At The End Of FY 1995 (in thousands of dollars)

Assets		Liabilities	
Loans receivable	$8,154	Debt to Treasury	$3,113
Less:			
Allowance for subsidy costs	(5,041)		
Loans Receivable, Net	$3,113		

[19]Amortization can alternatively be computed as interest expense other than reestimates $(471) minus the sum of interest income from borrowers $(400), interest income from reestimates $(168), and interest income on fund balance with Treasury $(0). These figures are derived in section C below.

C. Revenues And Expenses

The accounting standard for post-1991 direct loans requires that interest accrued on direct loans, including amortized interest, be recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

In this example, interest income for fiscal year 1995 is $471, which consists of the following items:

Nominal interest	$400
Amortized interest	(97)
Interest reestimates	168
Total interest income	**$471**

Interest expense on the debt to Treasury for the fiscal year is also $471, which equals the debt to Treasury of $7,859 at the beginning of the year times 6 percent. It is financed with the following sources:

Collections from borrowers	$303
Interest on reestimated subsidy payments	168
Total interest expense	**$471**

Costs of administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized separately as administrative expenses. Administrative expenses are not included in calculating the subsidy costs of direct loans.

D. Modification Of Post-1991 Direct Loans

The accounting standard on modifications states that 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.

Readers should refer to the text of the standard and to Appendix A, Basis of the Board’s Conclusions, for a more detailed definition of modifications.

Assume that in October 1995, shortly after the close of fiscal year 1995, Congress passed legislation to aid the borrowers. The legislation forgave some of the outstanding loans, and extended the maturity of the remaining loans for one additional year (to the end of fiscal year 2000). It is estimated that 70 percent of the outstanding amounts, or $5,708, is forgiven.

The legislative action is within the definition of direct modification because it is a federal government action that directly changes the estimated subsidy cost and the present value of outstanding direct loans by altering the terms of existing contracts.

The accounting standard on modifications states that 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 value of the loans over their post-modification value. The amount of the modification cost is recognized as a modification expense when the loans are modified.

The accounting is implemented in the steps described below.

(1) Calculate The Pre-Modification Value

The pre-modification value is the present value of the net cash inflows of the direct loans estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

As used in this part and Part II of this Appendix, the current discount rate 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 loans under pre-modification terms or post-modification terms, whichever is appropriate.[20]

The cash flows of the loans under pre-modification terms during 1996-99 are assumed to be the same as the cash flows that were reestimated early in fiscal year 1996 for these years and that are shown in Table 4. Those cash flows are used to calculate the loans' pre-modification value. It is assumed that the Treasury rate for a comparable maturity (4 years) and applicable to the time of modification is 4.5 percent. As Table 7 below shows, the present value of the pre-modification cash flows discounted at 4.5 percent is $3,223.

[20]The definition of the current discount rate is provided in Appendix C, Glossary. [See Appendix E of this Volume.]

Table 7: Pre-Modification Value (in thousands of dollars, calculated at the current discount rate)

FY	P & I Payments	Default Losses	Net Cash Flows
1996	$2,246	$(1,348)	$ 898
1997	2,246	(1,348)	898
1998	2,246	(1,348)	898
1999	2,246	(1,348)	898
PV AT 4.5%	$8,058	$(4,835)	$3,223

(2) Calculate The Post-Modification Value

The loans' post-modification value is the present value of the loans' net cash inflows estimated at the time of modification under post-modification terms and discounted at the current discount rate (for a 5-year maturity).

The modification forgives 70 percent of the outstanding principal amounts, and requires the remaining 30 percent, or $2,446, be paid back in 5 years (instead of 4 years) starting with year 1996. The stated interest rate remains at 4 percent. As shown in Table 8 below, under the modified terms, the required annual principal and interest payment is $549.

Table 8: Payment Schedule Of The Modified Loans (in thousands of dollars)

FY	Payment	Interest	Principal	Year-end Loan Balance
1995				$2,446
1996	$549	$97	$452	1,994
1997	549	79	470	1,524
1998	549	61	488	1,036
1999	549	41	508	528
2000	549	21	528	0

It is estimated that 20 percent of the scheduled cash inflows of the modified loans would be lost due to defaults. The current discount rate for a maturity of 5 years is 5 percent. As Table 9 shows, the present value of the post-modification cash inflows discounted at 5 percent is $1,902.

Table 9: Post-Modification Value (in thousands of dollars, calculated at the current discount rate)

FY	P & I Payments	Default Losses	Net Cash Flows
1996	$549	$(110)	$439
1997	549	(110)	439
1998	549	(110)	439
1999	549	(110)	439
2000	549	(110)	439
PV AT 5%	$2,377	$(475)	$1,902

(3) Calculate And Recognize The Cost Of Modification

The cost of modification is the excess of the pre-modification value over the post-modification value. Since the pre-modification value is $3,223, and the post-modification value is $1,902, the cost of modification is $1,321, which is recognized as a subsidy expense for modifications.

(4) Calculate The Change In The Loans' Book Value

The accounting standard on direct loan modifications requires that when post-1991 direct loans are modified, their existing book value be 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 is originally used to calculated the present value of the direct loans, when the direct loans were disbursed).

In this example, the original discount rate is 6 percent. As Table 10 below shows, the present value of the net cash inflows estimated under the modified terms and discounted at 6 percent is $1,849.

Table 10: Post-Modification Book Value (in thousands of dollars, calculated at the original discount rate)

FY	P & I Payments	Default Losses	Net Cash Flow
1996	$549	$(110)	$439
1997	549	(110)	439
1998	549	(110)	439
1999	549	(110)	439
2000	549	(110)	439
PV AT 6%	$2,312	$(463)	$1,849

At the time the modification action is taken, the existing book value of the loans is $3,113. The book value is changed to $1,849. This represents a decrease in book value by $1,264.

Table 11 displays the effect of the modification on the book amounts. The table shows that, due to the forgiveness, (1) the outstanding balance of the loans receivable is reduced from $8,154 to $2,446, (2) the book value is reduced from $3,113 to $1,849, and (3) the subsidy cost allowance, which is the difference between the gross amount and the book value, is changed from $5,041 to $597.

Table 11: Change In The Value Of Modified Loans (in thousands of dollars)

	Gross Amount	Book Allowance	Value
Before Modification	$8,154	$(5,041)	$3,113
After Modification	$2,446	$(597)	$1,849

(5) Calculate The Gain Or Loss And The Debt To Treasury

The accounting standard on direct loan modifications states that 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 transfer[21] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

The change in book value in this case is $1,264, compared to the cost of modification of $1,321. The amount of the modification cost exceeds the change in book value by $57. This excess is recognized as a gain.

The credit program receives a subsidy appropriation equal to the cost of modification. Since the cost of modification exceeds the decrease in book value by $57, the credit program pays to the Treasury a modification adjustment transfer of $57 to offset the excess. This is reported as a reduction in financing source.

The $1,321 subsidy appropriation received minus the $57 modification adjustment transfer paid is used to repay debt to Treasury. As a result, the debt to Treasury is reduced by $1,264 from $3,113 to $1,849.

Table 12 displays the asset and liability balances after the modification in October 1995.

Table 12: Assets And Liabilities After Modification In October 1995 (in thousands of dollars)

Assets		Liabilities	
Loans Receivable	$2,446	Debt to Treasury	$1,849
Less:			
Allowance for subsidy cost	(597)		
Loans Receivable, Net	$1,849		

(6) Provide Disclosures

The accounting standard requires that disclosure be made in notes to financial statements to explain the nature of the modification of direct loans, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification.

[21] 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 if the cost of modification exceeds the decrease in book value, the reporting entity pays to Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)

With respect to the modification described above, a footnote disclosure should be made in the financial statements for fiscal year 1996. The disclosure would explain the following:[22]

(a) The direct loans in the cohort of fiscal year 1994 were modified in October 1995. The modification was to forgive 70 percent of the outstanding loans and to extend the maturity of the remaining loans to the end of fiscal year 2000.

(b) The modification expense is $1,321, which is the decrease in the present value of the cash flows from that estimated under pre-modification terms to that estimated under post-modification terms, discounted at the current interest rate of marketable Treasury securities of similar maturity. The pre-modification cash flows were discounted at the current discount rate of 4.5 percent, which was applicable to a maturity of 4 years, and the post-modification cash flows were discounted at the current discount rate of 5 percent, which was applicable to a maturity of 5 years.

(c) As a result of the modification, the book value of the loans receivable decreased by $1,264, from $3,113, as reported at the end of fiscal year 1995, to $1,849. The difference between this decrease in book value and the modification expense, which amounts to $57, is recognized as a gain in the operating statement.

E. Write-off Of Direct Loans

The accounting standard on write-off of direct loans requires that when post-1991 direct loans are written off, the unpaid principal of the loans be 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.

Direct loans in this example that are determined to be uncollectible are written off as of the end of fiscal year 1996. However, before the write-off, accounting is performed for the year-end reestimation, the amortization of the allowance for subsidy costs, and the recording of collections and payments. This takes the following steps:

(1) The Reestimation Of The Subsidy Cost Allowance

In early fiscal year 1997, before the write-off, the credit program makes a year-end reestimation for the subsidy cost allowance. This reestimation is for the balances calculated as of the end of fiscal year 1995 adjusted for the modification in October 1995 (Table 12). The result of the

[22] The disclosure will not be illustrated for other modifications explained in this Appendix.

reestimation indicates that 20 percent of the outstanding loan payments due after the modification were lost because of defaults for fiscal year 1996, and the expected loss would be 30 percent in fiscal year 1997 and thereafter. The reestimated loss of 30 percent for fiscal year 1997 and the subsequent years is 10 percentage points more than the previous estimate made in October 1995, when the loans were modified. As Table 13 below shows, the net present value of the reestimated net cash inflows, discounted at the original rate of 6 percent to the end of fiscal year 1995, is $1,670.

Table 13: Subsidy Cost Reestimation: Projected Cash Flows Discounted To The End of FY 1995 (in thousands of dollars)

FY	P & I Payments	Default Losses	Net Cash Flows
1996	$549	$(110)	$439
1997	549	(165)	384
1998	549	(165)	384
1999	549	(165)	384
2000	549	(165)	384
PV AT 6%	$2,313	$(643)	$1,670

Based on the reestimate, the direct loans' book value is reduced by $179, from $1,849 to the reestimated present value of $1,670. This is accomplished by adjusting the subsidy cost allowance upward by $179, from $597 to $776. The increase of $179 in the subsidy cost allowance is recognized as subsidy expense reestimates.

A subsidy payment of $179 equal to the subsidy cost increase resulting from the reestimate is received under permanent indefinite authority and is used to reduce debt to Treasury. As a result, the debt to Treasury is reduced from $1,849 to $1,670. Furthermore, the direct loan program also receives a payment under permanent indefinite authority to cover the interest accrued on the increased subsidy expense of $179. The payment is $11, which equals $179 times the applicable Treasury interest rate of 6 percent. This amount is recognized as interest income reestimates, and the money is used to pay interest accrued for fiscal year 1996 on the $179 borrowed from Treasury, that is repaid by the subsidy reestimate.

The following table displays the asset and liability balances as of the end of fiscal year 1995, adjusted for the modification in October 1995 and the results of the reestimate that is calculated in early fiscal year 1997.

Table 14: Assets And Liabilities As Of The End Of FY 1995: Amounts Adjusted For Modification In October 1995 and Reestimates Calculated In Early FY 1997 (in thousands of dollars)

Assets		Liabilities	
Loans Receivable	$2,446	Debt to Treasury	$1,670
Less: Allowance for subsidy cost	(776)		
Loans Receivable, Net	$1,670		

(2) The Amortization Of The Subsidy Cost Allowance

The subsidy cost allowance is amortized as of the end of fiscal year 1996. The amortized amount equals the loans' effective interest minus their nominal interest. The loans' effective interest for fiscal year 1996 is $100, which is the loan's book value of $1,670, as reestimated, times the original discount rate of 6 percent. The loans' nominal interest is $98, which is the loans' nominal outstanding balance of $2,446 times the stated interest rate of 4 percent. Thus, the amortized amount is $2, which is the effective interest minus the nominal interest. The amortized amount is recognized as interest income, and the allowance for subsidy costs is reduced by $2, and becomes $774.

(3) Collections and Payments

Of the scheduled annual payment of $549 for fiscal year 1996, payments of $439 are received from the borrowers, which equal 80 percent of the scheduled payments. Of the amount received, $78 is interest payment (which equals 80 percent of the loans' balance of $2,446 times the stated interest rate of 4 percent), and the remaining $361 is principal repayment. The outstanding nominal principal of the loans is reduced by $361 to $2,085. There is unpaid accrued interest of $20 (which equals 20 percent of the loans' nominal balance as of the end of fiscal year 1995 times the stated interest rate of 4 percent). At this point of time, the loans' book value is $1,331, which equals the outstanding principal of $2,085, plus interest receivable of $20, minus the subsidy cost allowance of $774.

The debt to Treasury was $1,849 after the modification in October 1995. Of that amount, $179 has been paid off with the subsidy payment received as a result of the reestimate, which reduces the debt to $1,670; and the $11 of accrued interest on the $179 has been paid off with the interest on the reestimate. The interest accrued on the remaining debt is $100, which equals the debt balance of $1,670 times the Treasury interest rate of 6 percent. Of the $439 in payments received from the borrowers, $100 is used to pay interest due Treasury, and the remaining $339 is used to reduce debt to Treasury. As a result, the balance of debt to Treasury becomes $1,331.

Table 15 displays the asset and liability balances after the amortization and the recording of collections and payments at the end of fiscal year 1996.

Table 15: Assets And Liabilities After Amortization At The End Of FY 1996 (in thousands of dollars)

Assets		Liabilities	
Loans Receivable	$2,085	Debt to Treasury	$1,331
Interest Receivable	20		
Less: Allowance for subsidy costs	(776)		
Loans & Interest Receivable, Net	$1,331		

(4) Write-Off of Uncollectible Direct Loans

It is confirmed that non-performing loans with an outstanding balance of $489 (20 percent of the direct loan balance after modification in October 1995) are in default and will not be collected. The credit program is authorized to write off those loans, and the unpaid accrued interest of $20. The total amount of the write-off is $509. Thus, the principal is reduced by $489 to $1,596, and the interest receivable of $20 is written off. The subsidy cost allowance is reduced by $509, from $774 to $265.

The loans' book value is not changed by the write-off; it remains $1,331, which equals the remaining principal of $1,596, minus the subsidy allowance of $265. Table 16 below shows the asset and liability balances after the write-off.

Table 16: Assets And Liabilities After The Write-off As Of The End Of FY 1996 (in thousands of dollars)

Assets		Liabilities	
Loans Receivable	$1,596	Debt to Treasury	$1,331
Less: Allowance for subsidy costs	(265)		
Loans Receivable, Net	$1,331		

The book value of $1,331, as indicated in the above table, equals the present value of estimated net cash inflows of the remaining outstanding loans. The estimated cash flows and the present value calculations are shown in Table 17.

In Table 17 the amounts in column (a) are the scheduled annual principal and interest payments. Since the principal of the outstanding loans is $1,596 and the remaining life of the loans is 4 years, the required annual payment is $439. The amounts in column (b) equal the default amounts reestimated at the end of fiscal year 1996 minus the scheduled payments of the loans that have been written off (recoveries on those loans are assumed to be zero). The amounts in column (c) are the projected net cash inflows of the outstanding loans.

Table 17: Projected Cash Flows After Loan Write-off: Discounted To The End Of FY 1996 (in thousands of dollars)

FY	P & I Payments	Default Losses	Net Cash Flows
1996	$ 549	$(110)	$ 439
1997	549	(165)	384
1998	549	(165)	384
1999	549	(165)	384
2000	549	(165)	384
PV AT 6%	$2,313	$(643)	$1,670

It should be noted that to calculate the amortization correctly in subsequent periods, the unpaid principal and interest should be written out of the nominal principal balance. The amortization would be distorted if the unpaid amounts were kept in the nominal principal balance and continued to accrue interest. However, direct loan programs may need to keep the non-paying loans in their accounting records until collection efforts are exhausted and the loans are authorized to be written off. The non-paying loans and interest accrued on them should be accounted for separately, so that the amortization of the subsidy cost allowance of the performing loans can be calculated correctly. Readers should consult Treasury, OMB, or GAO, for guidance on accounting for non-paying loans.

F. Sale Of Direct Loans

The accounting standard on sale of loans states that the sale of post-1991 and pre-1992 direct loans is a direct modification.[23]

It is assumed that after the close of fiscal year 1996, the credit program is authorized to sell the loans. In October 1996, all of the loans are sold with recourse. The net proceeds from the sale

[23] This assumes that the sales proceeds were not included in the cash flow estimates for the initial subsidy calculation.

amount to $1,100. Accounting for the sales takes the steps explained in the paragraphs that follow.

(1) Recognize The Cost of Modification

The accounting standard on sale of loans requires that the cost of modification be 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.

The pre-modification value of the loans sold is the present value of the loans' net cash inflows estimated under pre-modification terms and discounted at the current discount rate.

The net cash inflows of the direct loans estimated prior to the sale are assumed to be the same as those estimated after the loan write-off at the end of fiscal year 1996 (shown in Table 17). It is assumed that the current discount rate for a similar maturity (4 years) is 5 percent. To calculate the pre-modification value, the net cash flows are now discounted at the current discount rate of 5 percent. As Table 18 shows, the pre-modification value of the loans sold is $1,362.

Table 18: Pre-Modification Value Of The Loans Sold, As Of October 1996 (in thousands of dollars, calculated at the current discount rate)

FY	P & I Payments	Default Losses	Net Cash Flows
1997	$439	(55)	$384
1998	439	(55)	384
1999	439	(55)	384
2000	439	(55)	384
PV AT 6%	$1,557	$(195)	$1,362

The pre-modification value of the loans sold exceeds the net proceeds of $1,100 from the sale by $262, which is recognized as a modification expense. The credit program receives an appropriation equal to that amount to cover the modification cost. (The credit program must have an appropriation equal to the modification cost before it can sell the loans.)

(2) Recognize Book Value Gain Or Loss

The accounting standard on sale of direct loans states that 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.[24] For sales of post-1991 direct loans, the modification adjustment transfer paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

The existing book value of the loans sold is $1,331. Upon the sale, this amount is removed from the books. At the same time, the net proceeds of $1,100 from the sale are recorded. The book value loss is $231. The accounting standard requires that any difference between the book value loss and the cost of modification be recognized as a gain or loss. In this case, the cost of modification is $262 and the book value loss is $231. The difference of $31 is recognized as a gain. Under the OMB instructions, this amount will be paid to Treasury as a modification adjustment transfer, and is recorded as a reduction in financing sources.

(3) Recognize the Subsidy Expense on Recourse

The accounting standard on sale of loans requires that for a loan sale with recourse, potential losses under the recourse or guarantee obligations be estimated, and that the present value of the estimated losses from the recourse be recognized as subsidy expense when the sale is made and as a loan guarantee liability.

It is estimated that 10 percent of the loans sold with a principal of $160 would default at the end of fiscal year 1997. Upon their default, the federal credit program will pay the loan purchaser an amount equal to the defaulted principal plus accrued interest. The estimated future default payment is $166, which equals the principal of the loans that are expected to default plus the 4 percent nominal interest of $6 accrued on those loans for one year.

At the time the loans are sold, the interest rate of Treasury securities of a similar maturity is 5 percent. The present value of the estimated default payment discounted at 5 percent is $158. This amount is recognized as a subsidy expense and a loan guarantee liability. The credit program receives an appropriation of $158 to cover the guarantee expense, which is paid to the loan guarantee financing account and becomes part of the fund balance of that account. (An appropriation must be available to cover the subsidy expense before the loans can be sold, since the payment to the loan guarantee financing account must be made in order for the guarantee to take effect.)

[24]If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.

At this point, the credit program has $1,489 in cash, which was derived from the following events:

Net proceeds from the loan sale	$1,100
Appropriation to cover the modification cost	262
Appropriation to cover estimated recourse liability	158
Less: modification adjustment transfer	(31)
Total in fund balance	**$1,489**

The credit program uses $1,331 to pay off the debt to Treasury, which was borrowed to finance the direct loans. The remaining balance of $158 has been paid to the loan guarantee financing account (as stated above). That amount, together with interest for one year at 5 percent, is to cover the recourse liability of the loan guarantee financing account.

Part II: Pre-1992 Direct Loans

Pre-1992 direct loans are direct loans obligated prior to October 1, 1991, and are recorded in liquidating accounts. **The accounting standard requires that the losses of pre-1992 direct loans be recognized when it is more likely than not that the direct loans will not be totally collected. The allowance of the uncollectible amounts should be reestimated each year as of the date of the financial statements. In estimating losses, the risk factors discussed in the standard for post-1991 direct loans should be considered.**

The standard further states that restatement of pre-1992 direct loans on a present value basis is permitted but not required.

All of the amounts used in the text that follows are in thousands of dollars.

A. Provision For Uncollectible Amounts

Assume that at the end of fiscal year 1994 a credit program has pre-1992 direct loans with outstanding principal of $5,000 at 7 percent interest rate, maturing in three years (at the end of fiscal year 1997). The program management evaluates the risk factors enumerated in the accounting standard, and estimates that the net loss of principal due to defaults would be $2,000. Thus, the program management provides an allowance of $2,000 for uncollectible amounts, and charges that amount to bad debt expense.[25] Thus, the book value of the loans is $3,000, as shown below:

Loans receivable	$5,000
Less uncollectible amounts	(2,000)
Loan receivable, net	**$3,000**

B. Modification Of Pre-1992 Direct Loans

Assume that in October 1994, shortly after the close of fiscal year 1994, a decision is made to take the following actions: (1) forgive 50 percent of the amounts due, (2) lower the interest rate to 4 percent, and (3) extend the due date to the end of fiscal year 2000.

These actions are within the definition of direct modification because they are federal government actions that would directly change estimated subsidy costs and the present value of outstanding direct loans by altering the terms of existing contracts.

The accounting standard on direct loan modifications states that with respect to a direct or indirect modification of pre-1992 direct loans, the cost of modification is the excess of the pre-modification value of the loans over their post-modification value. The amount of the modification cost is recognized as a modification expense when the loans are modified.

Accounting for the cost of modification takes the following steps:

(1) Calculate The Pre-Modification Value

The pre-modification value is the present value of the net cash inflows of the direct loans estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

It is estimated that under the pre-modification terms, 40 percent of the cash flows would be lost due to defaults in fiscal year 1995 and each year thereafter. The current discount rate for a maturity of 3 years is 4 percent. As Table 19 below shows, the present value of the estimated net cash inflows discounted at 4 percent is $3,172. This is the pre-modification value of the loans.

[25] This assumes that no allowance for uncollectible amounts was provided prior to fiscal year 1994. If there is an allowance for uncollectible amounts, that allowance should be adjusted to the current estimate and the difference between the current estimate and the existing allowance should be charged to bad debt expense.

Table 19: Pre-Modification Value (in thousands of dollars, calculated at the current discount rate)

FY	P & I Payments	Default Losses	Net Cash Flows
1995	$1,905	$(762)	$1,143
1996	1,905	(762)	1,143
1997	1,905	(762)	1,143
PV at 4%	$5,287	$(2,115)	$3,172

(2) Calculate The Post-Modification Value

The loans' post-modification value is the present value of the loans' net cash inflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification reduces the outstanding principal by 50 percent to $2,500, lowers the nominal interest rate to 4 percent, and extends the maturity by 3 years to the end of fiscal year 2000. As shown in Table 20 below, under the post-modification terms, the required payments will be $477 per year for six years.

Table 20: Payment Schedule Of The Modified Loans (in thousands of dollars)

FY	Payment	Interest	Principal	Year-end Loan Balance
1994	$477			$2,500
1995	477	$100	$377	2,123
1996	477	85	392	1,731
1997	477	69	408	1,323
1998	477	53	424	899
1999	477	36	441	458
2000	477	19	458	0

Taking into consideration that the loans owed by borrowers with poor conditions have been forgiven, it is estimated that only 10 percent of the cash flows would be lost due to defaults. The current discount rate for a maturity of 6 years is 5 percent. As shown in Table 21, the present value of the estimated net cash inflows discounted at 5 percent is $2,179. This is the loans' post-modification value.

Table 21: Post-modification Value (in thousands of dollars, calculated at the current discount rate)

FY	P & I Payments	Default Losses	Net Cash Flows
1995	$477	$(48)	$429
1996	477	(48)	429
1997	477	(48)	429
1998	477	(48)	429
1999	477	(48)	429
2000	477	(48)	429
PV at 5%	$2,421	$(242)	$2,179

(3) Calculate And Recognize The Cost Of Modification

The cost of modification is the excess of the loans' pre-modification value over the loans' post-modification value. Since the loans' pre-modification value is $3,172, and their post-modification value is $2,179, the cost of modification is $993, which is recognized as a subsidy expense for modifications.

The credit program receives an appropriation of $993 to cover the modification expense, which is paid to the financing account. The financing account, in turn, pays this amount to the liquidating account as part of its payment to acquire the loans. (A subsidy appropriation equal to the cost of modification must be available before the modification can take place.)

(4) Calculate The Change In Book Value And The Gain Or Loss

With respect to modifications of pre-1992 direct loans, the standard requires that when pre-1992 direct loans are directly modified, they be transferred to a financing account and their book value be changed to an amount equal to their post-modification value.

Any subsequent modification is treated as a modification of post-1991 loans.[26]

The change in book value of pre-1992 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

[26] The accounting standard provides that when pre-1992 direct loans are indirectly modified, they are kept in a liquidating account; and that their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification. Indirect modifications of pre-1992 direct loans are not illustrated.

cost of modification and the change in the loans' book value due to modification is recognized as a gain or loss.

Prior to the modification, the book value of the loans was recorded in the liquidating account at $3,000. Upon modification, the loans are transferred from the liquidating account to the financing account and recorded at their post-modification value of $2,179. The change in book value is a decrease of $821. Since the cost of modification is $993, and the change in book value is $821, the difference of $172 is recognized as a gain.

The financing account pays the liquidating account an amount equal to the loans' pre-modification value of $3,172. This comes from two sources. First, the financing account receives the $993 that is appropriated for the cost of modification. Second, the financing account borrows from Treasury the remainder, which is $2,179, the post-modification value of the loans. In exchange, the liquidating account transfers to the financing account the loan assets that had a book value of $3,000 before the modification was made. The gain to the liquidating account is $172, which, as shown above, equals the difference between the cost of modification and the change in book value of the loans.

Post-1991 loan guarantees are loan guarantees committed after September 30, 1991. The accounting standards for post-1991 loan guarantees are explained and illustrated through the use of an example described below:

A cohort of 5-year term loans that amounts to $10 million in face value is guaranteed by a federal loan guarantee program. The guarantee covers 60 percent of the principal and interest payments. The borrowers are required to pay interest annually at 7 percent, and to repay the principal when the loans mature at the end of the the year. The government agrees to pay a 1 percent interest supplement to the lenders at the end of each year over the loans' life. The loans are disbursed on September 30, 1994. The federal loan guarantee program collects a fee of 5 percent, when the loans are disbursed. The average interest rate of marketable Treasury securities of a similar maturity for the period in which the guaranteed loans are disbursed is 6 percent.

All of the amounts used in the text that follows are in thousands of dollars.

Part III: Post-1991 Loan Guarantees

A. Reporting The Liability Of Post-1991 Loan Guarantees And Their Subsidy Costs

The accounting standard for post-1991 loan guarantees requires that for guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees be

recognized as a liability. Disclosure is made of the face value of the guaranteed loans outstanding and the amount of the outstanding balance that is guaranteed.

To implement the standard in the example, cash flow estimates and present value calculations are prepared. It is projected that the borrowers would pay interest when due, but would default on 60 percent, or $6,000, of the principal repayments. Upon default, the federal credit program will pay 60 percent of the defaulted principal, equal to $3,600, to the lenders. It is projected that a net recovery of $2,000 will be realized a year later through the foreclosure and sale of pledged assets. The fees of $500 are received when the guaranteed loans are disbursed.

Table 22 below shows the estimated cash flows and the present values of the cash flows.

Table 22: Projected Cash Flows Discounted To The Time Of Disbursement (in thousands of dollars)

FY	Fee Receipts	Interest Supplements	Net Default Payments	Recoveries	Cash Flows
1994	$(500)				$(500)
1995		$100			100
1996		100			100
1997		100			100
1998		100			100
1999		100	$3,600		$3,700
2000				$(2,000)	(2,000)
PV at 6%	$(500)	$421	$2,690	$(1,410)	$1,201

The present value of the estimated net cash outflows of the loan guarantees is $1,201. This amount is recognized as a liability.

Disclosure is made in a footnote to the financial statements for fiscal year 1994 that guaranteed loans have an outstanding principal of $10,000, and the guaranteed amount is $6,000. (A similar disclosure is made in each year so long as the guaranteed loans are outstanding.)

The accounting standard for post-1991 loan guarantees requires that for guaranteed loans disbursed during a fiscal year, a subsidy expense be recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the guaranteed 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 disbursed (hereinafter referred to as the applicable Treasury interest rate).

In the example, the present value of the cash outflows minus the present value of the cash inflows is $1,201, which is recognized as a subsidy expense.

The accounting standard for post-1991 loan guarantees requires that for the fiscal year during which new guaranteed loans are disbursed, the components of the subsidy expense of those new loan guarantees be recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

The interest subsidy cost of the loan guarantees is the present value of the interest supplement payments to the lenders, which, in this example, is $421.

The default cost is the present value of the projected default payments minus the present value of net recoveries. The present value of the default payments is $2,690, and the present value of the net recoveries is $1,410. Thus, the default cost is $1,280.

The present value of fee collections, which is $500, is recognized as a deduction from subsidy costs.

There are no other subsidy costs in this example.

The subsidy expense of the loan guarantees is the sum of the above cost components, which is $1,201, calculated as follows:

Interest subsidy cost	$421
Fee collections	(500)
Loan default cost	1,280
Total subsidy cost	**$1,201**

The loan guarantee program receives an appropriation equal to the subsidy cost of $1,201. When the guaranteed loans are disbursed, the appropriated amount is paid to the loan guarantee financing account and is recorded in fund balance with Treasury. The $500 of fees are collected at the same time. The amount of the fees is debited to fund balance with Treasury and credited to the liability of the loan guarantees. Thus, the fund balance is raised to $1,701, on which Treasury pays 6 percent interest. The loan guarantee liability is also raised from $1,201 to $1,701.

Table 23 shows the projected cash flows and their present values after the receipt of fees.

Table 23: Projected Cash Flows Discounted To The End Of FY 1994, After The Receipt Of Fees (in thousands of dollars)

FY	Interest Supplements	Default Payments	Net Recoveries	Net Cash Flows
1994				
1995	$100			$100
1996	100			100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(2,000)	(2,000)
PV at 6%	$421	$2,690	$(1,410)	$1,701

Table 24 displays the asset and liability balances at the end of the 1994 fiscal year.

Table 24: Assets And Liabilities At The End Of FY 1994 (in thousands of dollars))

Assets		Liabilities	
Fund Balance with Treasury	$1,701	Loan Guarantee Liability	$1,701

B. Liability Reestimation And Interest Compounding

(1) The Reestimation Of The Liability Of Loan Guarantees

The accounting standard for post-1991 loan guarantees requires that the liability for loan guarantees be reestimated each year as of the date of the financial statements. Since the liability represents the present value of the net cash outflows of the underlying loan guarantees, the reestimation takes 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 loan guarantee liability resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the liability of loan guarantees and reestimates by component is not required.

In Appendix A, the Basis of the Board’s Conclusions, it is pointed out that the primary factor that causes changes in the subsidies would be default reestimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and reestimates.

In the example, it is initially estimated that 60 percent of the loans will default on the principal repayments when the loans mature at the end of fiscal year 1999, and that $2,000 will be recovered from the sale of foreclosed assets. The first reestimate is made early in fiscal year 1995. Because so little time has passed since the subsidy was initially estimated, the estimated cash flows are unchanged and the reestimate is zero. (This illustration assumes that the interest rates at the time of commitment and disbursement are the same, so no reestimate is needed for the difference in interest rates.)

The second reestimation of the subsidy cost is made early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It reestimates the loan guarantee liability as of the end of fiscal year 1994. It indicates that the initial default estimate is correct. However, it also indicates that the net recovery realized at the end of fiscal year 2000 would be $1,000, rather than $2,000. As shown in Table 25, because of the decrease in the amount of recovery, the present value of the net cash outflows discounted to the end of fiscal year 1994, is $2,406, rather than $1,701, as previously estimated for the end of fiscal year 1994 and shown in Table 23.

Table 25: Subsidy Cost Reestimation: Projected Cash Flows Discounted To The End Of FY 1994 (in thousands of dollars)

FY	Interest Supplements	Default Payments	Net Recoveries	Net Cash Flows
1995	$100			$100
1996	100			100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(1,000)	(1,000)
PV at 6%	$421	$2,690	$(705)	$2,406

The reestimated liability is $2,406, compared to the existing liability of $1,701, an increase of $705. The increase of $705 is added to the loan guarantee liability and is recognized as a subsidy expense reestimates.

The credit program receives a subsidy payment under permanent indefinite authority equal to $705 to cover the cost increase resulting from the reestimate. In addition, a payment of $42 is also received under permanent indefinite authority to cover the interest accrued on the $705 reestimate payment for the period from the end of fiscal year 1994 to the end of fiscal year 1995, and is reported as interest income. The total amount of $747 received is added to the fund balance.

(2) Interest Compounding

The accounting standard for post-1991 loan guarantees requires that interest be 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.

With the passage of time, the present value of the liability of the loan guarantees increases at a rate equal to the rate of interest used to discount the liability. The increase for fiscal year 1995 is $144, which equals the balance of the liability of $2,406, as reestimated, multiplied by the interest rate of 6 percent. The amount of the increase in the present value of the liability is added to the liability balance, and concurrently it is recognized as interest expense. As a result, the liability becomes $2,550.

Interest is also accrued on the credit program's fund balance of $1,701 at 6 percent. The amount of interest accrued is $102, which is added to the fund balance, and is recognized as interest income. As mentioned previously, the payments of $747 to cover the reestimated subsidy cost and the accrued interest are also added to the fund balance.

The interest supplement of $100 is paid for fiscal year 1995. Both the fund balance and the liability are reduced by $100.

As a result of the above transactions, the fund balance becomes $2,450, calculated as follows:

Fund balance at the end of FY 1994	$1,701
Interest on the fund balance	102
Subsidy payment reestimates	705
Interest on subsidy payment reestimates	42
Interest supplement paid	(100)
Fund balance at the end of FY 1995	**$2,450**

The loan guarantee liability is also $2,450 at the end of fiscal year 1995, calculated as follows:

Liability balance at the end of FY 1994, as reestimated	$2,406
Increase due to passage of time	144
Interest supplement paid	(100)
Liability balance at the end of FY 1995	**$2,450**

Table 26 displays the asset and liability balances at the end of the 1995 fiscal year.

Table 26: Assets And Liabilities After Interest Accumulations At The End Of FY 1995 (in thousands of dollars)

Assets		Liabilities	
Fund Balance with Treasury	$2,450	Loan Guarantee Liability	$1,701

C. Revenues And Expenses

The accounting standard for post-1991 loan guarantees requires that interest accrued on the liability of loan guarantees be recognized as interest expense, and that interest due from Treasury on uninvested funds be recognized as interest income. Interest accrued on debt to Treasury, if any, is recognized as interest expense.

In the example, interest accrued on the liability of loan guarantees is $144, which equals the reestimated liability of $2,406 times 6 percent. The amount is recognized as interest expense, and the same amount is added to the liability, as explained above.

Interest income recognized for fiscal year 1995 is also $144, consisting of (a) interest income of $102 on the fund balance, which equals the fund balance of $1,701 times 6 percent, and (b) interest income of $42 on the subsidy payment reestimates.

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

D. Modification Of Post-1991 Loan Guarantees

Assume that in October 1995, shortly after the close of fiscal year 1995, the loan guarantee program takes action to expand its guarantee from 60 percent of the outstanding loan principal to 80 percent. This action is within the definition of direct modification because it is a government action that directly changes the estimated subsidy cost and the present value of the loan guarantee liability by altering the terms of the loan guarantee agreement.

The accounting standard on modifications of loan guarantees states that 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 liability of the loan guarantees over their pre-modification liability. The modification cost is recognized as modification expense when the loan guarantees are modified.

The accounting is implemented in the steps described below.

(1) Calculate the Pre-modification Liability

The 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 current discount rate.

As used in this part and Part IV of this Appendix, the current discount rate is the interest rate applicable at the time of modification on marketable Treasury securities with a similar maturity to the remaining maturity of the guaranteed loans under pre-modification terms or post-modification terms, whichever is appropriate.[27]

The cash flows for the loan guarantees under pre-modification terms during 1996-2000 are assumed to be the same as the cash flows that were reestimated early in fiscal year 1996 for these years and that are shown in Table 25. Assume that the current discount rate for a comparable maturity (4 remaining years) is 4 percent. As Table 27 shows, the present value of the pre-modification net cash outflows discounted at 4 percent is $2,618.

[27]The definition of the current discount rate is provided in Appendix C, Glossary. [See Appendix E of this Volume.]

Table 27: Pre-modification Liability (in thousands of dollars; calculated at the current discount rate)

FY	Interest Supplements	Default Payments	Net Recoveries	Net Cash Flows
1996	$100			$100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(1,000)	(1,000)
PV at 4%	$363	$3,077	$(822)	$2,618

(2) Calculate Post-modification Liability

The loan guarantees' post-modification liability is the present value of the loan guarantees' net cash outflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification increases the guarantee percentage from 60 percent to 80 percent. It is estimated that 60 percent or $6,000 in principal repayments will default. This estimate is not affected by the modification. However, with the expansion of the guarantee percentage, the credit program will pay 80 percent of the defaulted amounts, equal to $4,800, to the lenders. The net cash outflows estimated under the post-modification terms are discounted at the current rate of 4 percent. As shown in Table 28 below, the present value of the estimated net cash outflows is $3,644. This is the post-modification liability of the loan guarantees.

Table 28: Post-modification Liability (in thousands of dollars; calculated at the current discount rate)

FY	Interest Supplements	Default Payments	Net Recoveries	Net Cash Flows
1996	$100			$100
1997	100			100
1998	100			100
1999	100	$4,800		4,900
2000			$(1,000)	(1,000)
PV at 4%	$363	$4,103	$(822)	$3,644

(3) Calculate And Recognize The Cost Of Modification

The cost of modification is the excess of the loan guarantee's post-modification liability over their pre-modification liability. Since the loan guarantees' post-modification liability is $3,644, and their pre-modification liability is $2,618, the cost of modification is $1,026, which is recognized as a subsidy expense for modifications.

(4) Calculate The Change In The Book Value Of The Liability

The accounting standard on loan guarantee modifications requires that the existing book value of the liability of modified post-1991 loan guarantees be changed to an amount equal to the present value of the 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 is originally used to calculate the present value of the liability, when the guaranteed loans were disbursed).

In this example, the original discount rate is 6 percent. The present value of the loan guarantees' net cash outflows estimated under the modified terms and discounted at 6 percent is $3,401. (See Table 29.)

Table 29: Post-modification Book Value Liability (in thousands of dollars; calculated at the original discount rate)

FY	Interest Supplements	Default Payments	Net Recoveries	Net Cash Flows
1996	$100			$100
1997	100			100
1998	100			100
1999	100	$4,800		4,900
2000			$(1,000)	(1,000)
PV at 6%	$346	$3,802	$(747)	$3,401

At the time the modification action was taken, the existing book value of the loan guarantee liability was $2,450 (See Table 26). The book value is changed to $3,401. This is an increase of $951 in the book value of the loan guarantee liability.

(5) Recognize A Gain Or Loss

The accounting standard on loan guarantee modifications states that 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. Any difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer[28] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

The change in book value in this case is $951, compared to the cost of modification of $1,026. The difference between those two amounts is $75, which is recognized as a gain.

The credit program receives a subsidy appropriation equal to the cost of modification. Since the cost of modification exceeds the increase in book value by $75, the credit program pays to Treasury a modification adjustment transfer of $75 to offset the gain. This is reported as a reduction in financing source. The net effect of the modification is to increase the fund balance of the credit program by $951 to $3,401.

[28]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 if the cost of modification exceeds the increase in liability, the reporting entity pays to Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)

Table 30 displays the asset and liability balances after the modification in October 1995.

Table 30: Assets And Liabilities After The Modification In October 1995 (in thousands of dollars)

Assets		Liabilities	
Fund Balance with Treasury	$3,401	Loan Guarantee Liability	$3,401

E. Default And Foreclosure

Assume that for fiscal year 1996 and thereafter, annual reestimations do not result in any changes in cash flow estimates.[29] After accumulating interest at 6 percent and paying the $100 interest supplement annually, the credit program has $3,856 in its fund balance with Treasury at the end of fiscal year 1999, prior to paying any default claims. Table 31 shows annual changes in the fund balance.

Table 31: Fund Balance (in thousands of dollars)

At the End of FY	Interest Accrued	Interest Supplement Paid	Fund Balance
1995			$3,401
1996	$204	$(100)	3,505
1997	210	(100)	3,615
1998	217	(100)	3,732
1999	224	(100)	3,856

At the same time, the program's loan guarantee liability at the end of fiscal year 1999 is also $3,856, which equals the estimated default claim payment of $4,800 minus $943, the present value of the estimated net recovery from foreclosing assets. It has been estimated that the net recovery would be $1,000 and would be realized at the end of fiscal year 2000. The present value of the net recovery discounted to the end of fiscal year 1999 at the original discount rate of 6 percent is $943.

As expected, when the guaranteed loans mature at the end of 1999, $6,000 of the principal is in default. To meet its guarantee obligation, the loan guarantee program must pay 80 percent of the default amount, or $4,800, to the lenders. When the defaults occur, the loan guarantee program

[29]This assumption is made only to avoid repetitious illustrations.

in this example has the options to foreclose property pledged by the borrowers who defaulted, and/or to acquire the loans involved, as a compensation for the default payment.

The accounting standard on foreclosure requires that when property is transferred from borrowers to a federal credit program, through foreclosure or other means, as a compensation for losses that the government sustained under post-1991 loan guarantees,[30] the foreclosed property be recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

The accounting standard states that 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.

In this example, the default occurs at the loans' maturity and virtually no cash inflows can be realized either from selling the loans or collecting payments from the borrowers. The loan guarantee program therefore forecloses the assets. It continues to estimate that the net cash inflow from possessing and selling the foreclosed property will be $1,000 and will be received at the end of fiscal year 2000. The present value of the estimated net cash inflow discounted at the original rate of 6 percent to the end of fiscal year 1999 is $943.

The accounting standard requires that 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 present value of the estimated claim be recognized as a special contra valuation allowance.

In this example, no such claim is assumed. Thus, the present value of the foreclosed property is recorded as an asset at $943. Concurrently, the amount of $943 is credited to the loan guarantee liability, so that the loan guarantee liability is increased from $3,856 to $4,800.

The default payment of $4,800 is more than the fund balance of $3,856, and the loan guarantee program does not receive cash from selling the foreclosed assets until one year later. The loan guarantee program borrows the difference of $943 from Treasury.[31] Thus, the fund balance is increased by $943 to $4,800, allowing the default payment to be made.

[30]The accounting standard is the same for property transferred in partial or full settlement of post-1991 direct loans, and the application of the standard to direct loans is illustrated by the present example of loan guarantees.

[31]Borrowing from Treasury is necessary in this example because all default payments occur at the same time. If they occurred in different years, the default payments in most cases might be covered by the fund balance and the proceeds from selling foreclosed assets. Borrowing would only be needed for defaults near the maturity date of the guaranteed loans.

When the default payment is made, both the fund balance and the loan guarantee liability are reduced to zero. The credit program takes collection action against the borrowers. However, further recovery is not anticipated. At this time, the loan guarantee program has the following asset and liability balances as shown in Table 32.

Table 32: Assets And Liabilities At the End of FY 1999 (in thousands of dollars)

Assets		Liabilities	
Foreclosed property	$943	Debt to Treasury	$943

F. Disposition Of The Foreclosed Property

The foreclosed property is initially recorded at the present value of the estimated net cash inflows. Until the property is sold, the present value of the property must be updated to recognize changes in value due to the passage of time. The recognition is made through an accrual of interest at the original discount rate. The amount of interest accrued for fiscal year 2000 is $57, which equals the book value of the foreclosed property at the beginning of the fiscal year, which is $943, times the original discount rate of 6 percent. This amount of interest is recognized as interest income, and is added to the book value of the foreclosed property. As a result, the book value of the foreclosed property becomes $1,000 at the end of fiscal year 2000.

Interest is also accrued on the debt to Treasury of $943 at the rate of 6 percent. The amount of interest for fiscal year 2000 is $57, and is recognized as interest expense. The amount is added to the debt to Treasury. As a result the debt to Treasury becomes $1,000 at the end of fiscal year 2000.

It is assumed that the property is sold at the end of fiscal year 2000 and the amount of net proceeds from the sale is $1,000. The amount of the net proceeds is used to pay off the debt to Treasury. As a result, the asset and liability balances for this cohort of loan guarantees are reduced to zero.

A reestimation should be performed for the net cash flow of the property after the end of fiscal year 2000. If the reestimation resulted in a reduction of the present value of the property, the amount of the reduction would be recognized as subsidy expense reestimates. As illustrated in preceding sections on reestimates, a payment from permanent indefinite authority would be available to cover the subsidy reestimate expense. In this case, because the property was sold at the estimated time for the estimated amount, there is no reestimate subsidy expense.

Part IV: Pre-1992 Loan Guarantees

Pre-1992 loan guarantees are loan guarantees committed prior to October 1, 1991, and the liabilities under pre-1992 loan guarantees are recorded in liquidating accounts. **The accounting standard requires that the liabilities of pre-1992 loan guarantees be recognized when it is more likely than not that the loan guarantees will require a future cash outflow to pay default claims. The liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating liabilities, the risk factors discussed in the standard for post-1991 loan guarantees should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.**

The standard states that restatement of pre-1992 loan guarantees on a present value basis is permitted but not required.

All of the amounts used in the text that follows are in thousands of dollars.

A. Recognition Of Liabilities

Assume that a federal credit program guarantees a group of loans and the guarantee was committed prior to October 1, 1991. At the end of fiscal year 1994, the loans have outstanding principal of $5,000 at 7 percent interest rate, maturing in three years. The borrowers are required to pay interest annually and to repay the principal at the end of 1997. The guarantee covers 60 percent of the principal.[32]

Disclosure is made in a footnote to the financial statements for fiscal year 1994 that guaranteed loans have an outstanding principal of $5,000, and the guaranteed amount is $3,000. (A similar disclosure is made in each year so long as the guaranteed loans are outstanding.)

The program management evaluates the risk factors enumerated in the accounting standard, and estimates that $2,500 of the loans' principal repayments would be defaulted when the loans mature. The program will pay 60 percent of the defaulted amount, equal to $1,500. It is also estimated that the credit program would realize a net recovery of $500 through acquiring and selling pledged assets. Thus, the program management recognizes a liability of $1,000, which equals the estimated default payment minus the net recovery. The $1,000 is charged to default expense.[33]

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[32]A loan guarantee may guarantee both principal and interest payments. In that case, the estimate and recognition of loan guarantee liabilities should be based on defaults on both principal and interest payments.

[33]This assumes that no liability was previously recognized. If a liability has been recognized for the loan guarantees, the liability should be adjusted to the current estimate, and any increase in liability should be charged to default expense.

B. Modification Of Pre-1992 Loan Guarantees

Assume that in October 1994, shortly after the close of fiscal year 1994, a decision is made to increase the guarantee from 60 percent of the loan payments to 80 percent. This action is within the definition of direct modification because it is a federal government action that directly changes the estimated subsidy cost and the present value of outstanding loan guarantees by altering the terms of existing contracts.

The accounting standard on modifications of loan guarantees states that 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 liability of the loan guarantees over their pre-modification liability. The modification cost is recognized as modification expense when the loan guarantees are modified.

Accounting for the cost of modification takes the following steps:

(1) Calculate the Pre-modification Liability

The pre-modification liability is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

It is estimated that under the pre-modification terms, a default payment of $1,500 would be made at the end of fiscal year 1997, and a net recovery of $500 from the sale of foreclosed assets would be received at the end of fiscal year 1998. The current discount rate for a maturity of 3 years is 4 percent. As shown in Table 33, the present value of the estimated net cash outflows discounted at 4 percent is $906. This is the pre-modification liability of the loan guarantees.

Table 33: Pre-modification Liability (in thousands of dollars, calculated at the current discount rate)

FY	Default Payments	Net Recoveries	Net Cash Outflow
1995			
1996			
1997	$1,500		$1,500
1998		$(500)	(500)
PV at 4%	$1,333	$(427)	$ 906

(2) Calculate The Post-modification Liability

The loan guarantees’ post-modification liability is the present value of the loan guarantees’ net cash outflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification expands the guarantee from 60 percent to 80 percent. It is estimated that $2,500 of the principal repayments will default when the loans mature. With the expansion of the guarantee percentage, the credit program will pay 80 percent of the defaulted amounts, equal to $2,000, to lenders at the end of fiscal year 1997. A net recovery of $500 would be received from selling foreclosed assets at the end of fiscal year 1998. The cash outflows estimated under the post-modification terms are discounted at the current discount rate of 4 percent. As shown in Table 34 below, The present value of the estimated net cash outflow is $1,351. This is the post-modification liability of the loan guarantees.

Table 34: Post-modification Liability (in thousands of dollars, calculated at the current discount rate)

FY	Default Payments	Net Recoveries	Net Cash Outflows
1995			
1996			
1997	$2,000		$2,000
1998		$(500)	(500)
PV at 4%	$1,778	$(427)	$1,351

(3) Calculate And Recognize The Cost of Modification

The cost of modification is the excess of the loan guarantees' post-modification liability over their pre-modification liability. Since the loan guarantees' post-modification liability is $1,351, and their pre-modification liability is $906, the cost of modification is $445, which is recognized as a subsidy expense for modifications. A subsidy appropriation of that amount is required before the modification can take place. The appropriated amount is paid to the financing account.

(4) Calculate The Change In The Book Value of The Liability

With respect to modifications of pre-1992 loan guarantees, the standard requires that when pre-1992 loan guarantees are directly modified, they be transferred to a financing account and the existing book value of the liability of the modified loan guarantees be changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees.[34]

Prior to the modification, the liability of the loan guarantees was recorded in a liquidating account at $1,000. Upon modification, the loan guarantees are transferred from the liquidating account to a financing account, since this is a direct modification. The liability is recorded in the financing account at the post-modification liability of $1,351. The change in book value of the liability is an increase of $351.

[34]The accounting standard states that when pre-1992 loan guarantees are indirectly modified, they are kept in a liquidating account, and that the liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification. Indirect modifications of pre-1992 loan guarantees are not illustrated in the Appendix.

(5) Recognize a Gain or Loss

The accounting standard on loan guarantee modifications states that 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. Any difference between the change in liability and the cost of modification is recognized as a gain or loss.

In this case, the cost of modification is $445, and the change in book value is $351. The difference of $94 is recognized as a gain.

When the loan guarantees are transferred from the liquidating account to the financing account, the liquidating account pays the financing account an amount equal to the loan guarantees' pre-modification liability of $906. The transfer of the loan guarantees has the following effects on the liquidating account: (1) the existing liability of the transferred loan guarantees equal to $1,000 is removed, (2) the fund balance is reduced by $906, which is the amount paid to the financing account, and (3) a gain of $94 is recognized.

The financing account records the liability of the loan guarantees at $1,351, which is their post-modification liability. It also records a fund balance of $1,351, which consists of the $906 received from the liquidating account, and the $445 appropriated to cover the cost of modification.

Statement of Federal Financial Accounting Standards 3: Accounting for Inventory and Related Property

Status

Issued	October 27, 1993
Effective Date	For fiscal years beginning after September 30, 1993.
Affects	None.
Affected by	• SFFAS 7, amends par. 69, 70, 72 and 74-77, plus Table 2, Summary of Accounting Standards, and Table 1, Summary of Accounting Standards--Forfeited Property. • SFFAS 32 amends par. 28, 30, 35, 50, 55, 56, 66, 71, 78, 91, and 109. • SFFAS 48 amends par. 20, 22-26, 42, 44, and 53.
Related Guidance	• Interpretation 7, *Items Held for Remanufacture.* • TR 4, *Reporting on Nonvalued Seized and Forfeited Property*.

Summary

This statement provides accounting standards that apply to several types of tangible property, other than long term fixed assets, held by federal government agencies. These accounting standards cover the following assets:

- inventory (i.e., items held for sale);
- operating materials and supplies;
- stockpile materials;
- seized and forfeited property;
- foreclosed property; and
- goods held under price support and stabilization programs (including nonrecourse loans and purchase agreements).

Inventory Held For Sale

The standards require reporting of inventory by categories as follows: (1) inventory held for sale, (2) inventory held in reserve for future use, (3) excess, obsolete, and unserviceable inventory, and (4) inventory held for repair.

The standards require historical cost or latest acquisition cost valuation of inventory held for sale and inventory held in reserve for future sale. The standards permit use of any other valuation method (e.g., standard cost) which reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. The standards do not provide for use of the last-in, first-out cost flow assumption or lower of cost or market valuation. When latest acquisition cost valuation is used the inventory is revalued periodically and an allowance account is established for unrealized holding gains and losses.

Excess, obsolete and unserviceable inventory is to be valued at net realizable value. Inventory held for repair is to be valued at either historical cost or latest acquisition cost less an allowance for the estimated repair cost.

Operating Materials and Supplies

Operating materials and supplies are to be accounted for under the consumption method and valued at historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. In addition, categories for (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies must be reported.

An exception to the consumption method is provided when (1) the operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method. In any of these events, the purchases method may be used.

Stockpile Materials

Stockpile materials are to be accounted for through the consumption method using the historical cost valuation or any method that reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the material.

Seized and Forfeited Property

The market value of seized property other than monetary instruments is to be disclosed in the notes to the financial statements. Seized monetary instruments are recognized as assets with an offsetting liability. This treatment was provided to foster a higher level of control over seized monetary instruments.

Forfeited property is recognized as an asset upon forfeiture and valued at market value less any liens. Revenue recognition is deferred until sale except for monetary instruments. Special provisions are made for items seized in satisfaction of tax liabilities and for transfer of the property to government entities for their use.

Foreclosed Property

Foreclosed property must be classified as Post-1991 property or Pre-1992 property to remain consistent with the provisions of the Credit Reform Act of 1990. Post-1991 property is associated with loans or loan guarantees issued after September 30, 1991 and is valued at its net present value. Pre-1992 property is associated with loans or loan guarantees issued before September 30, 1991 and is valued at the lower of cost or net realizable value.

Goods Held Under Price Support and Stabilization Programs

Goods held under price support and stabilization programs (e.g., commodities) are valued at the lower of cost or net realizable value. For nonrecourse loan amounts the standards provide that allowances be established for expected losses and losses recognized if it is more likely than not that they will occur and the losses are measurable. For purchase agreements, the standards provide that contingent liabilities be established and losses recognized if it is more likely than not that a loss will occur and that the loss is measurable.

Table of Contents

Executive Summary

1. This is the third statement of recommended accounting standards issued by the Federal Accounting Standards Advisory Board (referred to as FASAB or the Board). The standards presented in this document apply to several types of tangible property, other than long term fixed assets, held by federal government agencies.

2. These accounting standards cover the following assets:

   - inventory (i.e., items held for sale);
   - operating materials and supplies;
   - stockpile materials;
   - seized and forfeited property;
   - foreclosed property; and
   - goods held under price support and stabilization programs (including nonrecourse loans and purchase agreements).[1]

3. The following tables summarize the provisions in the recommended accounting standards. The tables highlight the **major** provisions; they should not be substituted for close review of the standards themselves.

[1]As well as addressing the commodities acquired through price support and stabilization programs, this standard addresses nonrecourse loans and purchase agreements.

Table 1: Summary of Accounting Standards

Standard	Description	Valuation methods	Recognition requirements and comments
Inventory	Tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be used in the provision of services for a fee.	(1) Historical cost or any other valuation methods which approximate historical cost (2) Latest acquisition cost	An asset upon receipt of title or goods. As cost of goods sold upon delivery to buyer. For latest acquisition cost, an allowance account will be established equal to the cumulative unrealized holding gains/losses associated with ending inventory. Categories will be established for inventory held for sale; inventory held in reserve for future sale; excess, obsolete and unserviceable inventory; and inventory held for repair.
Operating materials and supplies	Tangible personal property to be consumed in normal operations	Historical cost or any other valuation methods which approximate historical cost.	The consumption method shall be applied. However, if operating materials and supplies are (1) not significant amounts, (2) in the hands of the end-user, or (3) if it is not cost beneficial to apply the consumption method, the purchases method may be applied. Categories will be established for operating materials and supplies; operating materials and supplies held in reserve for future use; excess, obsolete and unserviceable operating materials and supplies; and operating materials and supplies held for repair.
Stockpile materials	Strategic and critical materials held due to statutory requirements for use in national defense, conservation, or national emergencies	Historical cost or any other valuation methods which approximate historical cost	As an asset upon receipt of title or goods. As an expense upon disposal, use, or sale.

Table 2: Summary of Accounting Standards

Standard	Description	Valuation methods	Recognition requirements and comments
Seized and forfeited property	Monetary instruments and property acquired as a result of forfeiture proceedings	Market value	As an asset upon forfeiture with a deferred revenue established.[a] As revenue upon sale or disposition of nonmonetary forfeited property. As revenue upon forfeiture for monetary instruments.
Foreclosed property	Assets received in satisfaction of a loan receivable or as a result of a claim under a guaranteed or insured loan	Post-1991;[b] net present value Pre-1992;[c] lower of cost or net realizable value	As an asset upon foreclosure
Commodities	Items acquired, held, sold or otherwise disposed of to stabilize or support market prices	Lower of cost or net realizable value	As an asset upon receipt. As a loss on farm price support if the net realizable value is less than the cost at acquisition. As an expense upon disposal or use.
Commodity nonrecourse loans	Short-term loans with commodities pledged as collateral	The principal amount of the loan less any allowance for expected losses	As an asset upon issuance. As a loss on farm price support at reporting date if they are more likely than not and measurable.
Commodity purchase agreements	Agreements to purchase commodities at a given price at the option of the seller	Estimated amount of the contingent loss	As a contingent liability if the loss is more likely than not and measurable.

[a] Seized property other than monetary instruments would not be recognized as the entity's asset since it is not owned by the government. However, the market value of seized property should be disclosed in notes to the financial statements. This recognizes that the entity has a fiduciary responsibility for the property.
Seized monetary instruments are recognized as assets with an offsetting liability to recognize the potential for remission to the owners. This treatment was provided in order to maintain a higher level of financial control over seized monetary instruments.

[b] "Post-1991" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees committed after September 30, 1991.

[c] "Pre-1992" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees committed before October 1, 1991. In addition, any programs or agencies that are specifically exempt from the provisions of the Federal Credit Reform Act should follow accounting provisions for "pre-1992" property.

Introduction

Objective

4. In this Statement, the Board recommends accounting standards for six assets of the federal government and its entities. The first group of assets addressed, those formerly referred to as “inventory,” includes inventory held for sale, operating materials and supplies, stockpile materials, and commodities. The decision to include other assets held for sale resulted in adding two items: (1) seized and forfeited property and (2) foreclosed property.

Approach

5. Following publication of the Board’s Exposure Draft Accounting for Inventory and Related Property on January 8, 1993, the Board received comments from 44 organizations and individuals. A public hearing, at which eight people presented oral comments on the Exposure Draft, was held on April 21 and 22, 1993.

6. In preparing this Statement of recommended standards, the Board considered all the comments received and incorporated changes, as appropriate. The issues raised and the specific changes made are discussed in Appendix A, “Basis of the Board’s Conclusions.”

Materiality

7. The Board intends that the standards’ application be limited to items that are material. “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. The Board relies on the Financial Accounting Standards Board’s (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board’s position on the issue of materiality at this time.

8. The accounting and reporting provisions of the Board’s accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

9. FASB’s Statement of Accounting Concepts No. 2, “Qualitative Characteristics of Accounting Information,” discusses the concept of materiality. According to this statement, the

determination of whether an item is material depends on the degree to which omitting or misstating information about this 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. 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.

10. The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.

11. In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.

12. This is expressed well in the Government Auditing Standards (the "Yellow Book"):

"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." (Ch. 3, par. 33.)

13. While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.

14. Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgment of the entity's efficiency and effectiveness and its compliance with laws and regulations in a material manner.

15. In order to emphasize that materiality should be considered in applying all accounting standards, the Board has decided to place a notice at the end of each recommended accounting standard. The notice will read as follows:

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

Effective Date

16. The Board recommends that the accounting standards presented in this Statement become effective for fiscal year ending September 30, 1994, and thereafter. Earlier implementation is encouraged.

Inventory

17. **Definition.** “Inventory” is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. The term “held for sale” shall be interpreted to include items for sale or transfer to (1) entities outside the federal government, or (2) other federal entities. The principal objective of the sale or transfer of inventory is to provide a product or service for a fee that generally recovers full cost or an identified portion of the cost. “Other federal entities” may include entities within the same organization/agency. Sales transactions may be executed through transfer of funds between federal entities; it is not essential that the transaction be an exchange of goods for cash or cash equivalents. In addition, inventory may be acquired through donation or barter. Inventory excludes some other assets held for sale, such as (1) stockpile materials, (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; however, the purpose of acquiring them is not to provide a product or a service for a fee.

18. Inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. These categories are defined in paragraphs 17, 27, 29, and 32 respectively.

19. **Recognition.** Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or the goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

20. **Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost.

21. (1) Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired

through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

22. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods.

23. [Paragraphs 23-25 were rescinded by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, paragraph 17.][2, 3]

24. [Paragraphs 23-25 were rescinded by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, paragraph 17.]

25. [Paragraphs 23-25 were rescinded by SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, paragraph 17.]

26. **Valuation Method for Opening Balances and Exceptions to Valuation.**

    a. **Alternative Valuation Method for Opening Balances**.[3a] Deemed cost[3b] is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials when a reporting entity is presenting financial statements, or one or more line items addressed by Statement of Federal Financial Accounting Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materia*ls, following generally accepted accounting principles (GAAP) promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in

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[2][Footnote 2 was rescinded by SFFAS 48, paragraph 17.]

[3][Footnote 3 was rescinded by SFFAS 48, paragraph 17.]

[3a]Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[3b]Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

applying an alternative valuation method:

i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[3c]that its financial statements, or one or more line items addressed by SFFAS 48, are presented fairly in accordance with GAAP.

ii. The application of this method based on the second condition specified above is available once per reporting entity.

iii. Reporting entities that meet either condition in paragraph 26a. and elect to apply the alternative valuation method in establishing opening balances permitted by SFFAS 48 are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles.*

iv. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[3d]

(1) Standard price (selling price)[3e] or fair value[3f]
(2) Latest Acquisition Cost[3g]
(3) Replacement cost[3h]
(4) Estimated historical cost (initial amount)
(5) (Actual historical cost (initial amount)

[3c]An unreserved assertion is an unconditional statement.

[3d]The methods are not listed in order of preference.

[3e]The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

[3f]Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)

[3g]The Latest Acquisition Cost (LAC) Method 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. FASAB Handbook Glossary as of June 30, 2014

[3h]Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

v. Disclosure requirements-A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. **Exceptions to Valuation**. An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:

i. Units of which are interchangeable,

ii. Units of which have immediate marketability,

iii. Units for which appropriate costs may be difficult to obtain.

Other Categories of Inventory

27. **Inventory Held in Reserve for Future Sale.** Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

28. The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. **Examples** of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage, and (5) the likelihood that

a supply of the items will be available in the future. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.

29. **Excess, Obsolete, and Unserviceable Inventory.** "Excess inventory" is inventory stock that exceeds the demand expected in the normal course of operations because the amount on hand is more than can be sold in the foreseeable future and that does not meet management's criteria to be held in reserve for future sale. "Obsolete inventory" is inventory that is no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable inventory" is damaged inventory that is more economical to dispose of than to repair. The category "excess, obsolete and unserviceable inventory" shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

30. Such inventory shall be valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. Any subsequent adjustments to its net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain). The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected not realizable value.

31. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.

32. **Inventory Held for Repair.** Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.

    (1) Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established. The annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.

33. (2) Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

34. Transition to either of these two methods may result in recognizing an accumulated amount of needed repairs that were not previously accounted for. To avoid overstating repair expense for the first period that repair expense is accrued, prior period amounts are to be separately identified or estimated. The estimated amount to repair inventory that is attributable to prior periods shall be credited to the repair allowance under the repair allowance method or to the inventory account under the direct method and reported as an adjustment to equity.

Disclosure Requirements

35.
- General composition of inventory.
- Basis for determining inventory values; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods; if any.
- Balances for each of the following categories of inventory; inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements.
- Restrictions on the sale of material.
- The decision criteria for identifying the category to which inventory is assigned.
- Changes in the criteria for identifying the category to which inventory is assigned
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Operating Materials And Supplies

36. **Definition.** "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

37. Operating materials and supplies shall be categorized as (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies. These categories are defined in paragraphs 36, 45, and 47 respectively.

38. **Recognition.** The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and supplies shall be recognized and reported as assets when produced or purchased. “Purchased” is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

39. The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.

40. If (1) operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

41. An end user is any component of a reporting entity that obtains goods for direct use in the component’s normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user.

42. **Valuation Under the Consumption Method.** Operating materials and supplies shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Operating Material and Supplies.

43. Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

44. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed.

Other Categories of Operating Materials and Supplies

45. **Operating Materials and Supplies Held in Reserve for Future Use.** Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.

46. The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

47. **Excess, Obsolete, and Unserviceable Operating Materials and Supplies.** “Excess operating materials and supplies” are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management’s criteria to be held in reserve for future use. “Obsolete operating materials and supplies” are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. “Unserviceable operating materials and supplies” are operating materials and supplies that are physically damaged and cannot be consumed in operations. The category “excess, obsolete and unserviceable operating materials and supplies” shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

48. Such operating materials and supplies shall be valued at their estimated net realizable value. The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete or unserviceable and their estimated net realizable value shall be recognized as a loss (or gain) and either reported separately or disclosed. Any subsequent adjustments to their estimated net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).

49. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies.

Disclosure Requirements

50.

- General composition of operating materials and supplies.
- Basis for determining operating materials and supplies values; including valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods, if any.
- Balances for each of the categories of operating materials and supplies described above.
- Restrictions on the use of material.
- Decision criteria for identifying the category to which operating materials and supplies are assigned.
- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Stockpile Materials

51. **Definition.** "Stockpile materials" are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business. The following items are specifically excluded from stockpile materials: (1) items that are held by an agency for sale or use in normal operations (see proposed standards for inventory and operating materials and supplies), (2) items that are held for use in the event of an agency's operating emergency or contingency (see proposed standard for operating materials and supplies), and (3) materials acquired to support market prices (see proposed standard for goods held under price support and stabilization programs).

52. **Recognition.** The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. "Purchase" is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile

materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.

53. **Valuation.** Stockpile materials shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Stockpile Materials. Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of stockpile materials.

54. **Exception to Valuation.** The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss or an expense[4] in the period in which it occurs.

55. **Held for Sale.** When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price.

Disclosure Requirements

56.

- General composition of stockpile materials.
- Basis for valuing stockpile materials; including valuation method and any cost flow assumption.
- Changes from prior year’s accounting methods, if any.
- Restrictions on the use of materials.
- Balances of stockpile materials in each category described above (i.e., stockpile materials and stockpile materials held for sale).
- Decision criteria for categorizing stockpile materials as held for sale.
- Changes in criteria for categorizing stockpile materials as held for sale.

[4]The decline in value shall be considered an expense if it is an expected decline in the normal course of operations.

- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Seized and Forfeited Property

57. As a consequence of various laws, certain property is seized by authorized law enforcement agencies. In some instances, there may be as many as three government entities involved with seized property. The first is the seizing agency. Second, the seizing agency may turn the property over to a custodial agency. Third, financial records may be maintained by a "central fund" created to support the seizure activities of multiple agencies. Alternatively, the seizing agency may carry out one or both of the custodial agency or central fund roles.

58. The seized assets may be subsequently forfeited to the government through abandonment or administrative or judicial procedures. The forfeited property is then sold, converted for use by the government, or transferred to other governmental entities. Because this property is first seized, then all or a portion of it is forfeited, this standard separately addresses the accounting and reporting for seized property and the accounting and reporting for forfeited property.

Seized Property

59. **Definition.** "Seized property" includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.

60. **Recognition.** Seized property shall be accounted for in the financial records of the entity that is operating as the central fund.[5]

61. Seized monetary instruments shall be recognized as seized assets when seized. In addition, a liability shall be established in an amount equal to the seized asset value. Seized monetary instruments are recognized upon seizure due to (1) the fungible nature of monetary instruments and (2) the high level of control over the assets that is necessary.

[5]If the central fund is other than the seizing or custodial agency, the latter should maintain sufficient internal records to carry out its stewardship responsibility.

62. Seized property other than monetary instruments shall be disclosed in the footnotes. The value of the seized property shall be accounted for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated.

63. **Valuation.** Seized property shall be valued at its market value[6] when seized or, if market value cannot be readily determined, as soon thereafter as reasonably possible. Market value shall be based on the value of the property assuming an active market exists for the property. If no active market exists for the property in the general area in which it was seized, a value in the principal market nearest the place of seizure shall be used.

64. **Exceptions to Valuation.** Valuation of property seized under the Internal Revenue Code shall be based on the taxpayer's equity, that is, market value less any third-party liens.

65. Seized monetary instruments shall be valued at their market value.

Disclosure Requirements

66.

- Explanation of what constitutes a seizure and a general description of the composition of seized property.
- Method(s) of valuing seizures.
- Changes from prior year's accounting methods; if any.
- Analysis of change in seized property, including the dollar value and number of seized properties that are (1) on hand at the beginning of the year, (2) seized during the year, (3) disposed of during the year, and (4) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seized property and method of disposition where material.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

Forfeited Property

67. This subsection defines "forfeited property" and presents the accounting and reporting standards for it. Presented below are examples of forfeited property.

[6] "Market value" is the estimated amount that can be realized by disposing of an item through arm's length transactions in the marketplace or 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. For investments in marketable securities, the term refers to the per-unit market price of a security times the number of units of that security held.

- monetary instruments,
- intangible property,
- real property and tangible personal property,
- property acquired by the government in satisfaction of a tax liability, and
- unclaimed and abandoned merchandise.

68. **Definition.** “Forfeited property” consists of (1) monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.

[SFFAS 7, par. 264-269 affect par. 69, 70, 71, and 74 through 77.]

69. **Recognition and Valuation.** Monetary instruments shall be reclassified from seized monetary instruments to forfeited monetary instruments when forfeited. Monetary instruments shall be valued at their market value when a forfeiture judgment is obtained. When the asset is recorded, revenue shall be recognized in an amount equal to the value of the monetary instrument and the associated liability for possible remittance shall be removed.

70. Intangible property, real property and tangible personal property shall be recorded with an offsetting deferred revenue when forfeiture judgment is obtained. The property shall be valued at its fair value at the time of forfeiture. A valuation allowance shall be established for liens or claims from a third-party. This allowance shall be credited for the amount of any expected payments to third-party claimants.

71. Forfeited property that cannot be sold due to legal restrictions but which may be either donated or destroyed shall be subject to the disclosure requirements described below. However, no financial value shall be recognized for these items. The U.S. government-wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions.

72. Revenue from the sale of property shall be recognized when the property is sold.

73. <u>Property not held for sale</u> may be

    --placed into official use,
    --transferred to another federal government agency,
    --distributed to a state or local law enforcement agency, or
    --distributed to a foreign government.

74. When a determination is made that property will be distributed in one of the ways described above and not held for sale, the property shall be reclassified as forfeited property held for donation or use. Revenue associated with property not disposed of through sale shall be recognized upon approval of distribution and the previously established deferred revenue shall be reversed.

75. Revenue shall be classified as it arises from sale or from disposition, and this distinction shall be maintained in the entity's accounting reports.

76. Property acquired by the government in satisfaction of a taxpayer's liability shall be recorded when title to the property passes to the federal government. At that time, a credit shall be made to the related account receivable. The property shall be valued at its market value less any third-party liens. Upon sale of the property, revenue shall be recognized in the amount of the sale proceeds and the property and the third-party liens are removed from the accounts.

77. Unclaimed and abandoned merchandise shall be recorded with an offsetting deferred revenue when statutory and/or regulatory requirements for forfeiture have been met. The merchandise shall be valued at its market value. Upon sale of the merchandise, revenue shall be recognized in the amount of the sale proceeds and the merchandise and the deferred revenue are removed from the accounts.

Disclosure Requirements

78.

- Composition of forfeited property.
- Method(s) of valuing forfeited property.
- Restrictions on the use or disposition of forfeited property.
- Changes from prior year's accounting methods, if any.
- Analysis of change in forfeited property providing the dollar value and number of forfeitures that (1) are on hand at the beginning of the year, (2) are made during the year, (3) are disposed of during the year and the method of disposition, and (4) are on hand at the end of the year. This information would be presented by type of property forfeited where material.
- If available, an estimate of the value of property or funds to be distributed to federal, state and local agencies in future reporting periods.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Table 1: Summary Of Accounting Standard—Forfeited Property

Category of property	Method of disposition	Valuation method	Recognized as assets	Recognized as revenue
Monetary instruments	Sale; proceeds credited to entity's fund	Market value	Upon seizure	Upon obtaining forfeiture judgment
Intangible property and real and tangible personal property acquired by forfeiture proceeding	Sale	Market value	Upon obtaining forfeiture judgment	Upon sale
	Transferred, distributed, or held for internal use	Market value	Upon obtaining forfeiture judgment	Upon obtaining approval to transfer, distribute or use internally
Property acquired to satisfy tax liability	Sale; proceeds credited to Treasury General Fund	Market value less amount of liens	Upon obtaining title to property	Upon sale of property
Unclaimed/ abandoned merchandise	Sale; proceeds used to reimburse other funds; excess credited to Treasury General Fund	Market value	Upon meeting statutory and/or regulatory requirements	Upon sale

Foreclosed Property

79. **Definition.** The term "foreclosed property" means any asset received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan (excluding commodities acquired under price support programs). All properties included in foreclosed property are assumed to be held for sale.

80. In accordance with the Federal Credit Reform Act of 1990, the remainder of this standard will refer to specific provisions for pre-1992 foreclosed property and post-1991 foreclosed property. "Pre-1992 foreclosed property" refers to property associated with **direct loans** obligated or **loan guarantees** committed before October 1, 1991. "Post-1991 foreclosed property" refers to property associated with **direct loans** obligated or **loan guarantees** committed after September 30, 1991. The distinction is necessary because for budget purposes, the cash flows associated with post-1991 direct loans and loan guarantees, including the cash flows associated with post-1991 foreclosed property, must be measured on a present value basis. However, pre-1992 foreclosed property need not be valued on this basis. Additionally, any programs that are specifically exempt from the use of present value

techniques for determining the costs of direct loans and loan guarantees shall rely on the accounting principles provided for pre-1992 foreclosed property.[7]

81. **Valuation of Foreclosed Property.** Post-1991 foreclosed property is valued at the net present value of the projected future cash flows associated with the property. Pre-1992 foreclosed property is recorded at cost and adjusted to the lower of cost or its net realizable value; any difference is carried in a valuation allowance. Both of these methods are described further below. For either post-1991 or pre-1992 foreclosed property, other valuation methods may be used as an approximation for the above methods if no material differences in valuation will result.

82. **Net Present Value.** The first step in determining net present value is projecting the future cash flows associated with the property. The projected future cash flows shall include estimates of (1) the sales proceeds, (2) rent, management expense, and repair costs during the holding period, and (3) selling expenses (e.g., advertising and commissions). In estimating the sales proceeds, the entity's historical experience in selling property and the nature of the sale shall be considered. For instance, market value based on sales between willing buyers and sellers may not be appropriate for properties to be disposed of in a forced or liquidation sale. If the entity has historically been unable to realize the fair value of property, this shall be considered in estimating sales proceeds.

83. The second step is to discount these cash flows to their present value. In order to place the projected cash flows on a present value basis, a discount (interest) rate must be selected. The discount rates used shall be the same rates that were used to discount the cash flows of the related loans or guarantees.

84. Following foreclosure, the net present value (measured in a manner consistent with the measurement at the time of foreclosure) shall be adjusted periodically to recognize both changes in the expected future cash flows and for accrual of interest due to the passage of time. Any adjustments to the carrying amounts shall be included in the presentation of "interest income" and the reestimate of "subsidy expense."[8]

85. **Net Realizable Value.** Pre-1992 foreclosed property held for sale should be reported in the entity's financial statements at expected net realizable value. The expected net realizable value shall be based on an estimate of the market value of the property adjusted for any expected losses and any other costs of the sale. The estimate of market value shall be

[7]Section 506 of the Federal Credit Reform Act exempts specific agencies, such as the Federal Deposit Insurance Corporation and the Tennessee Valley Authority.

[8]See FASAB exposure draft No. 2, *Accounting for Direct Loans and Loan Guarantees*, September, 1992.

based on (1) the market value of the property if an active market exists; (2) the market value of similar properties if no active market exists; or (3) a reasonable forecast of expected cash flows adjusted for estimates of all holding costs, including any cost of capital. In addition to considering market value, the expected net realizable value shall consider the entity's historical experience in disposing of foreclosed properties; i.e., if the entity is typically unable to obtain market value for properties, the expected net realizable value shall be adjusted to be consistent with historically experienced losses. Additionally, if the entity will not be able to sell the property under normal market conditions or is forced to sell the property within a given time, this factor shall be considered in arriving at net realizable value.

86. If the expected net realizable value is less than the cost,[9] a loss has occurred. This loss shall be charged to operations, and a valuation allowance shall be established. If the asset's net realizable value subsequently increases or decreases, this amount shall be credited or charged to results of operations and the valuation allowance adjusted. However, the asset value shall not be adjusted above cost.

87. **Assets Subject to Claims of Other Parties.** If the property is taken subject to claims of the lender, debtor, or other party, these claims shall be accounted for in a valuation allowance. These claims can be in the form of a lien or a residual interest of the debtor or lender, etc. For post-1991 foreclosed property, these claims shall be recorded at their net present value at the time of foreclosure. The discount rate applied shall be the same rate that applies to the related foreclosed property. For post-1991 foreclosed property, any periodic changes in the net present value of the claim shall be offset by a charge or a credit to "interest income" and the reestimate of "subsidy expense," as appropriate under the standards for direct loans and loan guarantees. For pre-1992 foreclosed property, these claims shall be recorded at the expected amount of the cash required to settle the claims.

88. **Receipts and Disbursements During the Holding Period for Post-1991 Foreclosed Property.** Any receipts or disbursements associated with acquiring and holding post-1991 foreclosed property shall be charged or credited to foreclosed property. This shall include rental receipts, maintenance and repair expense, advertising costs, and any other elements of the projected cash flows considered in arriving at the net present value.

89. **Sale of Foreclosed Property.** Upon sale, any difference between the net carrying amount of foreclosed property and the net proceeds of the sale shall be recognized as a component of operating results. For post-1991 foreclosed property, interest income shall be accrued from the previous periodic adjustment in the carrying amount up to the sale date. The

[9]Cost is the carrying amount of the loan at the time of foreclosure or, for a loan guarantee, the amount of the claim paid.

difference between the adjusted carrying amount and the net sales proceeds shall be recognized as a reestimate of "subsidy expense." For pre-1992 foreclosed property, this difference shall be recognized as a gain or a loss on the sale of foreclosed property.

90. **Assets Converted From Held-for-Sale Assets to Operating Assets.** Assets not sold but placed into operation shall be removed from foreclosed property when such action is taken. If reimbursement for the transfer of assets from one program to another is made, the proceeds from the transfer shall be treated in the same manner as a sale to a third-party.

Disclosure Requirements

91.

- Valuation basis used for foreclosed property.
- Changes from prior year's accounting methods, if any.
- Restrictions on the use/disposal of the property.
- Balances in the categories described above.
- Number of properties held and average holding period by type or category.
- Number of properties for which foreclosure proceedings are in process at the end of the period.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Goods Held Under Price Support And Stabilization Programs

92. **Definition.** Goods acquired under price support and stabilization programs are referred to as commodities. "Commodities" are items of commerce or trade having an exchange value. They are acquired, held, sold, or otherwise disposed of to satisfy or help satisfy economic goals.

93. In conducting price support operations, the money is frequently disbursed in the form of "nonrecourse loans." Recipients of such loans pledge specific farm commodities as collateral for the loans and have the alternatives of redeeming the loans (repaying them with interest) or surrendering the commodities in exchange for the outstanding loan balance.

94. Besides acquiring commodities through surrender of collateral for nonrecourse loans, an entity may acquire commodities by a purchase settlement. A purchase settlement is exercised on the basis of a purchase agreement between a producer and the Commodity

Credit Corporation (CCC). On the basis of the agreement, a producer has the option to sell commodities to CCC and receive full payment for the commodity at the price support rate. The amount of the purchase settlement is calculated by multiplying the price support rate by the number of units purchased by the CCC. Support price rates are set by law.

95. Because nonrecourse loans and purchase agreements are closely associated with the acquisition of the actual commodities, the three components of the price support program are addressed in this accounting standard.

96. **Recognition.** Nonrecourse loans shall be recognized as assets when the loan principal is disbursed. These loans shall be recorded at the amount of the loan principal. Interest income shall be recognized as it is earned and an interest receivable established.

97. Purchase agreement settlements are executed at the option of the producer (seller). This creates an uncertainty regarding losses to be incurred by the purchaser. At financial statement dates a loss shall be recognized if information indicates that it is probable that a loss has been incurred on purchase agreements outstanding and the amount of the loss can be reasonably measured. The amount of the loss shall be estimated and may be based on the contract price and the expected net realizable value of the commodities to be acquired.

98. If the contingent loss is not recognized because it is less than probable or it is not reasonably measurable, disclosure of the contingency shall be made if it is at least reasonably possible that a loss may occur.

99. Commodities shall be recognized as assets and reported on the face of the financial statements upon the producer's surrender of title to satisfy a nonrecourse loan or upon purchase by the agency.

100. Revenue shall be recognized upon the sale of commodities. At the time of sale, the carrying amount of the commodities sold shall be removed from commodities and reported as cost of goods sold.

101. The carrying amount of commodities held for other purposes shall be removed from the commodities asset account and reported as an expense upon transfer of the commodity.

102. **Valuation.** All nonrecourse loans shall be valued at the loan amount. Losses on nonrecourse loans shall be recognized when it is more likely than not that the loans will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence. The loan amount shall be preserved in the asset account as the gross value of the loan. When the loss is recognized, a valuation allowance, "allowance for losses", (a contra-asset) shall be established to reduce the gross value to its expected net realizable value. The allowance shall be reestimated on each financial reporting date.

103. The liability for losses on purchase agreements shall be valued at the net of the contract price and the net realizable value of the commodities described in the purchase agreement.[10]

104. At the time of acquisition and for financial statement purposes, all commodities shall be valued at the lower of cost or net realizable value.

105. The cost for commodities acquired via a nonrecourse loan settlement is the amount of the loan principal (excluding interest), processing and packaging costs incurred after acquisition, plus other costs (e.g., transportation) incurred in taking title to the commodity.

106. The cost for commodities acquired via a purchase settlement is the unit price agreed upon in the purchase agreement multiplied by the number of units purchased by CCC plus other costs (e.g., transportation) incurred in taking title to the commodity.

107. For financial statement purposes, any adjustments necessary to reduce the carrying amount of commodities to the lower of cost or net realizable value shall be recognized as a loss on farm price support and reported in the current period. The adjustment to the carrying amount shall be recorded in a commodity valuation allowance. Recoveries of losses may be recognized up to the point of any previously recognized losses on the commodities, and the commodity valuation allowance reduced accordingly in the current period.

108. For cost determination, any of the following cost flow assumptions may be applied in arriving at inventory balances and cost of goods sold or transferred: first-in, first-out (FIFO); weighted average; moving average; and specific identification.

Disclosure Requirements

109.
- Basis for valuing commodities; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods, if any.
- Restrictions on the use, disposal, or sale of commodities
- An analysis of change in the dollar value and volume of commodities, including those (1) on hand at the beginning of the year, (2) acquired during the year, (3) disposed of during the year by method of disposition, (4) on hand at the end of the year, (5) on hand at year's end and estimated to be donated or transferred during the coming period, and (6) that may be received as a result of surrender of collateral related to nonrecourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments.

[10]Contract price is the amount the government would be committed to pay in exchange for the commodities.

- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Appendix A: Basis Of The Board's Conclusions

110. This Appendix discusses the substantive comments that the Board received from respondents to the Exposure Draft, *Accounting for Inventory and Related Property*, issued in January 1993. The Appendix explains the Board's conclusions on issues raised by the respondents. A separate section is identified for each of the six recommended standards.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Inventory

111. Several respondents questioned the need for the various inventory categories proposed; inventory held in reserve for future sale; and excess, obsolete and unserviceable inventory. Respondents and speakers stated that (1) the requirement to segregate inventory and inventory held in reserve for future sale could result in arbitrary and subjective balance sheet allocations, (2) the category for excess, obsolete and unserviceable is unnecessary and (3) it is not cost-effective to modify systems to capture this data. However, other respondents supported the categories and indicated that they would result in more meaningful information.

112. Based on the comment letters received and the presentations at the public hearing, the objections seemed to be based on the belief that the Board intended to develop rigid guidelines for the categorization of inventory. However, it is apparent that these or similar categories are used internally by organizations. The Board is merely attempting to improve disclosure related to these categories. The Board concluded that the four categories should be maintained. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.

113. Several respondents opposed identifying the holding costs associated with inventory held in reserve for future sale. They indicated that the information has no apparent utility value, that it was virtually impossible to compute and maintain incremental holding costs for the reserve, and that disclosure would not provide managers with useful information to make relevant decisions. They also indicated that this requirement would be too subjective and difficult to audit. The Board discussed this issue and concluded that the identification of holding cost was a broad issue and deserving of more detailed treatment than could be afforded in the inventory standard. The Board agreed to drop the disclosure requirement

and to defer this issue until a later project on cost issues. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.

114. In the exposure draft, the Board requested opinions on two presentation formats for cost of goods sold and the change in the allowance for holding gains and losses under latest acquisition cost (LAC) (Par. 87). The following two cost of goods sold computations under the latest acquisition cost method where presented:

Proposed presentation: (Appendix A)	**Alternative presentation: (Appendix B)**
Cost of Goods Sold:	Cost of Goods Sold:
Beginning Inventory at LAC	Beginning Inventory at LAC
Purchases	less: Allowance
Cost of Goods Available for Sale	Purchases
less: Ending Inventory at LAC	Cost of Goods Available for Sale
Cost of Goods Sold	less: Ending Inventory at LAC
	less: Allowance
	Cost of Goods Sold
Nonoperating Change (Change in the Allowance for Unrealized Holding Gain/Loss on Inventory)	

115. Most respondents to the question regarding the two alternative cost of goods sold computations indicated a preference for the alternative presentation from Appendix B. These respondents stated that changes in cost were "operating" in nature and should be included in the operating results. It was also noted that comparability would be improved under the alternative treatment since cost of goods sold would approximate historical cost. Two respondents provided examples of the "distortion of cost of goods sold" that may result under the proposed presentation. The examples showed that cost of goods sold as calculated under the first proposed treatment (Appendix A of the ED) might actually be less than it would have been under historical cost.

116. In reviewing the responses, it was noted that the "nonoperating change" seems to have been confused by some respondents with the "unrealized holding gain/loss" for the period. The full title, "Nonoperating Change - Change in the Balance of the Allowance for Unrealized Holding Gains/Losses" is, although cumbersome, more descriptive. The change in the balance is made up of decreases, due to liquidation of inventory or cost decreases, and increases, due to holding more inventory or cost increases. The net change should not be confused with the "unrealized holding gain/loss" for the period.

117. The Board, after much discussion, decided to adopt the alternative presentation (Appendix B of the ED). This would avoid (1) confusion as to the significance of the "nonoperating change" and (2) distortion of the cost of goods sold. In addition, for those who wish to know

the change in the allowance account, the Board decided that line items should be included in the calculation of the cost of goods sold to show the beginning and ending balances.

118. Some respondents believed that the Board should adopt the lower of cost or market (LCM) rule (traditional under Accounting Research Bulletin (ARB) 43) for valuing inventory. Respondents supporting the LCM rule stated that:

- it provides a basis for measuring the utility of inventory, and
- the operating performance financial reporting objective seems to require that matching or assigning revenues and expenses to the appropriate period be a primary concern.

119. In evaluating the LCM rule the Board considered some of the unique facets of the Federal environment:

- pricing is often based on full cost recovery regardless of changes in market pricing, and
- managers are often required to stock inventory based on legislative or mission concerns that are not driven by profit maximization (therefore, cost fluctuations are not as relevant to performance measurement).

120. The Board concluded that there was no need to include the LCM rule in the inventory standards.

121. The Board requested comments on the impact of historical cost accounting on performance measurement, and the costs and benefits of market value accounting. The majority of respondents that addressed these questions expressed a preference for historical cost accounting due to its verifiability and understandability. They also believed that market value methods were too costly to implement and subjective. Another said that for most government operations, the goal is cost recovery and market value has little relevance.

122. One Board member believes that market value information is more relevant to decision makers than historical cost information. This opinion is shared by many in the academic community. However, the Board devoted considerable resources to the issue of measuring and reporting on holding gains and losses, an essential component of market value accounting, and was unable to resolve the issues that arose in a manner that would have been cost-effective. The Board has decided to rely primarily on historical cost accounting for inventory.

123. The Board also requested comments on the standard cost using replacement cost method. The method was described in detail in Appendix C to the exposure draft. “Standard costs” are defined as predetermined or budgeted per-unit costs. Standard costs are commonly used in manufacturing concerns and are being adopted in service industries as well.

124. In a standard cost system, variances between the actual per-unit cost and the standard per-unit rate are identified. Variances are typically calculated for the individual cost components, such as materials or labor, included in the overall per-unit rate.

125. Standard costs also provide managers useful information for managing inventory costs. As an agency purchases inventory during the year and incurs operating costs, the actual costs are compared with the standard costs to identify why the cost variances occurred. Since inventory and operating managers are evaluated against the standard, the managers have an incentive to meet the standard, which, in turn, provides for effective inventory cost control.

126. The distinction between the traditional standard cost system and that outlined in the exposure draft relates to replacement cost information. The method on which comments were requested would require standard costs based on the next period's expected replacement costs and overhead rates. Further, no adjustment to historical cost amounts would have been required for external reporting purposes.

127. The majority of the respondents cited substantially the same problems for this method as they cited for market value accounting in general. The calculations were viewed as complex, costly and subjective.

128. One Board member is concerned that this method would be excluded under the recommended standard. The Board does not believe that this is true. Standard cost systems, including replacement cost, are used internally in private industry to generate valuable management information. Standard cost information is then revised to approximate costs under historical cost bases because it is generally accepted accounting practices for financial reporting purposes. Therefore, a managerial costing system employing standards or replacement cost information that improves management's decision making could be entirely consistent with the standard so long as externally reported information approximates historical cost. Further, the Board expects to take up the issue of costing systems in a future project on cost measurement.

129. With regard to inventory held in reserve for future sale, one respondent indicated that the phrase "either reported or disclosed" (par. 39) implies off-balance sheet reporting. The respondent believes that this category should be reported on the balance sheet rather than disclosed. The Board concluded that the decision as to the level of detail shown on the balance sheet should be left to preparers and/or auditors. While the Board did not revise the standard to require reporting on the face of the financials, the language describing the reporting and disclosure options was clarified.

130. One respondent suggested that the standard be revised so that excess, obsolete and unserviceable inventory would be valued at the lower of cost or net realizable value rather

than at net realizable value. The respondent indicated that any gains on excess, obsolete or unserviceable inventory due to valuation at net realizable value should be recognized only upon disposal of such inventory and not when identified as such or upon periodic revaluations. Private sector GAAP, per ARB 43, requires that losses be recognized prior to disposal of inventory but that gains not be recognized until realized. This one-sided treatment has been criticized over the years but has survived based on the principle of conservatism that has prevailed.

131. Since the Federal government does not operate in a “for-profit” environment and does not seek financing from investors who rely on audited financial statements to make decisions, the conservative position taken in the past is not as relevant. However, the Board concluded that no change to the standard was required.

132. Some respondents commented on the absence of the last-in, first-out cost flow (LIFO) method under acceptable cost flow assumptions; stating that LIFO should be included as an acceptable option under historical cost since it tends to match current costs with current revenues. The Board did not include LIFO as an acceptable cost flow assumption due to the stale inventory values reported on the balance sheet as a result. However, the Board did permit use of any method that reasonably approximates historical cost under one of the acceptable cost flow assumptions. Therefore, LIFO could be acceptable for an entity whose inventory turns over rapidly since there may be little difference between LIFO and any other cost flow assumption.

133. One respondent requested that the standard specifically address goods: a) held on consignment, b) acquired through barter, c) donated, d) that must be maintained by statute but have no market value, or e) that will not be sold or consumed but which must be held (e.g., weights and measures). The Board concluded that goods held on consignment were not within the scope of this standard. Goods maintained by statute but having no market value, and goods that will not be sold or consumed but must be held would presumably be categorized as stockpile materials and therefore no change to the standards was warranted. The Board did decide that valuation of goods acquired through barter or donated should be addressed under the inventory, operating materials and supplies, and stockpile materials standards.

Operating Materials And Supplies

134. Respondents suggested that if a valuation method such as latest acquisition cost (LAC) is acceptable for inventory it should also be acceptable for operating materials and supplies. The Board agreed with this proposal since LAC approximates historical cost. Further, the Board believes that any method that approximates historical cost should be acceptable. The standard was revised accordingly.

Stockpile Materials

135. Respondents indicated that the definition of stockpile materials would encompass routinely held reserves as well as major stockpiles of materials. It was the Board's intention to include only those items specifically identified by law as being "stockpiled." Items routinely used but held in unusually large quantities would not be included in this category but would remain components of inventory or operating materials and supplies; possibly categorized as held in reserve for future sale or use.

136. In addition, one respondent identified helium reserves as being mandated by law for "conservation" purposes. The Board concluded that it would be consistent to include these reserves in stockpile materials. The definition has been clarified to limit stockpile materials to items held in order to comply with legal requirements established for purposes of defense, emergency or conservation.

137. As was the case for operating materials and supplies, respondents indicated that use of LAC would be appropriate for stockpile materials. The Board reached the same conclusion for this standard; that any method that approximates historical cost should be acceptable. The standard was revised accordingly.

138. One respondent suggested that an exception to permit market valuation for items that are interchangeable, have a ready market, and for which the unit cost is not determinable be added to the standard. The inventory standard provides this exception and the respondent suggested that it be available for stockpile material so that items such as strategic petroleum reserves could be valued at market value. The Board concluded that since these items are not routinely sold in large quantities the recognition of holding gains/losses may have an adverse impact on measurement of operating performance. Therefore, the exception was not added to the standard for stockpile materials.

Seized And Forfeited Assets

139. A respondent explained at the public hearing that a good portion of the forfeited assets are seized and valued under conditions which make accurate appraisals extremely difficult. As a result, there have been values reported for assets well in excess of what is eventually realized. The determination of the market value prior to the actual sale of the item is very difficult. The respondent has found that when the best estimate of market value is made on an item by item basis, the total value is still found to be overstated.

140. To avoid overstating deferred revenue, the respondent recommended that a valuation allowance be created to adjust the reported value of assets in the financial statements. The

valuation allowance would be based on historical trends or other relevant information; in a manner similar to that used to establish an allowance for uncollectible receivables. For example, information over the last six months may show sale proceeds were 5% to 10% less than appraised values. Further, the respondent believes that use of the valuation allowance would recognize the inherent difficulties in estimating market values and would present better financial information.

141. Although the proposal is not without merit, it may be an unnecessary exercise. Market value is an estimate of the amount to be realized upon disposal of the property and should take into account the marketplace in which the property is expected to be disposed of (e.g., auction, fire sale, retail or wholesale markets, etc.). The use of valuation allowances against any asset category is not prohibited. However, the Board does not believe it necessary to require the use of a valuation allowance in this circumstance.

142. One respondent requested that the standard require that, in addition to recording deferred revenue, deferred distributions be recorded. A respondent at the public hearing explained that historically as much as 50% of the forfeited property is eventually distributed to federal, state, and local law enforcement entities which participated in the case. It was further explained that once property has been forfeited, a participating state, local, or federal agency may have already applied to receive that asset because of its participation in the case. Therefore, the recording of deferred revenue could be accompanied, where appropriate, by the recording of an estimate of deferred distributions. The intent of this is to avoid reporting misleading information in the financial statements.

143. The deferred distribution would represent another level of estimates related to forfeited property. In discussions with representatives from other agencies that handle seized and forfeited property, the Board has been told that no reasonable estimate of deferred distributions was available.

144. In addition to the difficulty in estimating distributions, the Board notes that there is no legal requirement to make a specific distribution until an application has been approved. This is similar in a sense to dividends declared by for-profit enterprises. There is no legal obligation to make a payment until the actual declaration by the Board of Directors; and the entity does not record dividends payable until that time. Therefore, the Board has not revised the standard as suggested. However, the Board has added a disclosure requirement for any reasonable estimate of future distributions.

145. The comment letters also included proposals for miscellaneous changes to this standard:

1) In that the government does not have ownership, seized monetary instruments should be disclosed rather than reported on the face of the financials.

2) Seized property other than monetary instruments should be reported as assets, like monetary instruments, with a liability for possible remittance of equal value recorded.

3) For non-monetary forfeited assets the disclosure requirements are adequate to ensure information is available to users. Therefore, non-monetary forfeited assets should not be reported on the face of the financial statements.

4) At the time that forfeiture judgement is obtained, ownership of the property is effectively transferred to the federal agency and the government should recognize the revenue earned at that time rather than deferring it.

146. The first two suggestions relate to seized property. The Board considered these suggestions during its discussions of seized property. The Board did not revise the standard; this was based on (1) the desire to establish strong controls over monetary instruments and (2) the difficulties in valuing and uncertainties regarding disposition associated with seized non-monetary property.

147. The third and fourth items relate to forfeited property. The suggestion to disclose forfeited non-monetary instruments, item 3, would result in understatement of the entity's assets. Disclosure requirements should emphasize that the value reported is merely an "estimate" of the property's value. The suggestion to recognize revenue upon forfeiture, item 4, while theoretically correct was not adopted by the Board. Due to the difficulties in valuing forfeited property and the risk of overstating the revenue the Board decided to defer revenue recognition until the property was sold.

148. One respondent requested that the standard address valuation of property for which there is no value, which cannot be legally sold, but which can be donated to museums or other non-profit organizations (e.g., stuffed endangered species) or destroyed (e.g., narcotics). The standard was revised to clarify the disclosure requirements and to indicate that no financial value need be reported for these items. Entities are not prohibited from reporting information regarding the dollar value of illegal assets seized if they so chose. The standard only relates to financial recognition and disclosure.

149. One respondent indicated that the analysis of change in seizures disclosure requirement is very detailed and should not be required for agencies with only incidental seizure activity. The Board has indicated that the standard is not intended to be applied to immaterial items.

150. One respondent noted that the definitions of seized and forfeited property seem to be limited to monetary instruments, real property and tangible personal property. The respondent asked that this definition be extended to intangible assets (e.g., savings and loan charters). The Board did broaden the definition to address intangible property.

151. One respondent explained that the exposure draft can be interpreted to advise agencies to account for the assets through the seizing agency's property records and financial statements. However, in most cases, the seizing agency is different from the custodial agency which may take possession of seized property. In addition, there may be a central fund created to support activities of multiple agencies. It was recommended that the standard be modified to recognize the distinction among "seizing agencies", "custodial agencies", and the "central fund" responsible for accounting and reporting for the seized property; and, to remind seizing agencies of their responsibilities to maintain sufficient internal records to carry out their stewardship responsibilities.

152. The exposure draft had defined "seized property" as being "in the actual or constructive possession of the **seizing agency**." The respondent has correctly pointed out that this is not always the case since custodial agencies frequently take possession and/or responsibility for seized property. Depending on the circumstances, each party may have a need to maintain property records regarding seized property. For example, a seizing agency may wish to track property that may be ultimately distributed to it. In addition, seizing agencies may maintain physical possession of the property during the forfeiture process. The Board has modified the definition to include seized property held by custodial agencies.

153. With regard to the request for a clear statement of which agency is to maintain records on seized property, the Board believes that central fund would be responsible for accounting for and reporting seized property, but that seizing agencies or custodial agencies may have a need for property records related to seized property and does not wish to preclude them from doing so. However, in preparing consolidated financial statements care should be taken to avoid double counting these items. With regard to forfeited property, ownership should be the determinant for an entity's recognition of an asset. However, an agency that maintains physical custody, but not ownership, of forfeited property is not precluded from maintaining property records although no asset should be recognized.

Foreclosed Property

154. Many respondents objected to the requirement to value post-1991 foreclosed property at net present value (NPV). The primary objections to the use of NPV were:

- NPV is not a more accurate valuation basis than net realizable value (NRV)
- NPV does not improve the information presented
- Difference between NPV and NRV is immaterial
- Loss of comparability with commercial enterprises
- Maintenance of two systems to value foreclosed property (pre-1992 and post-1991) is costly and unnecessary
- Changes in existing systems would be complicated and expensive

- Cash flows may not be forecast with sufficient accuracy to measure NPV

155. In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 (the Act) and to make financial reporting compatible with the budget. Since foreclosed property is a result of the original loan transaction or loan guarantee, reporting on this activity should be guided by the provisions of the Act.

156. An extensive discussion of the Board's overall decision to require present value accounting is presented in Recommended Accounting Standard No. 2, *Accounting for Direct Loans and Loan Guarantees* (see Appendix A). One of the objectives of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget.[11] The Board believes that only by using the same basis can financial information be used to compare the actual results of operations with the budget.

157. However, the Board wishes to acknowledge that respondents may be correct in stating that in certain cases there may be only immaterial differences between net realizable value (or other methods) and NPV. The standard has been revised to indicate that if no material difference results, other valuation methods may be used as an approximation of the net present value of foreclosed property.

158. One respondent currently values foreclosed vessels at their acquisition price based on its own bid at the foreclosure sale. Following acquisition, the value is depreciated at one-percent per month. Gains or losses are recognized upon sale. The respondent believes that the current practice is more appropriate because: (1) the price paid at foreclosure sale represents the best valuation, (2) estimating future net cash flows requires assumptions and this would be less prudent than utilizing existing specific valuations, and (3) the entity has had to establish the value of the vessels in legal proceedings and has relied on the acquisition price to do so - utilizing a different value in financial records could jeopardize the entity's position in legal proceedings. The Board has not revised the standard as a result of this request. The Board believes that there are no unique circumstances in this case which would preclude conformance to the standard.

[11] FASAB Exposure Draft, Objectives of Federal Financial Reporting, Vol. 1, par. 13.

Goods Held Under Price Support And Stabilization Programs

159. The proposed standard required that nonrecourse loans be adjusted at time of disbursement to **recognize a loss if the market rate is lower than the loan rate**. This constituted a departure from current practice that is to adjust the loan values to their expected net realizable value at report date. Respondents expressed concern that the proposed method would result in recognizing losses without consideration of the underlying economic transaction (i.e., will the loans be repaid).

160. Based on two respondents' comments, the Board found that the approach originally proposed ignored the "probability" component in recognizing unrealized losses; these losses have typically been recognized only if they are "probable and measurable. Nonrecourse loans, being short-lived, are similar in nature to notes or accounts receivable. Therefore, the Board referred to its recommended standard for accounts receivable. That standard states that:

> Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence.
>
> An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value. The allowance for uncollectible amounts should be reestimated on each financial reporting date and when information indicates that the latest estimate is no longer correct. (FASAB, Recommended Accounting Standard 1, Paragraphs 44 and 45)

161. In addition, one respondent indicated that the originally proposed standard would have excluded loss recognition due to factors other than fluctuations in the market rates. Losses can occur due to (1) farmers' misuse or handling of the pledged commodities, or (2) fraud. Clearly the concept of loss recognition should be broadened in order to recognize these events. The Board modified the standard for nonrecourse loans to be more consistent with the accounts receivable standard and to encompass the Board's current thinking on the liability project.

162. One respondent argued that purchase agreements constitute a contingent liability. The proposed standard would require recognizing a liability and a loss **if the contract price exceeded the expected net realizable value of the commodities**. It is clear that at any given time the market price may be lower than the contract price but that due to cycles in the harvest and post-harvest market this may not be an indication that the contract will be executed and a loss realized. The Board revised the standard to provide for loss recognition in connection with purchase agreements if the loss is both probable and measurable.

Statement of Federal Financial Accounting Standards 4: Managerial Cost Accounting Standards and Concepts

Status

Issued	July 31, 1995
Effective Date	For fiscal years beginning after September 30, 1996. Subsequently modified to be for years beginning after September 30, 1997.
Affects	None.
Affected by	• SFFAS 9, *Deferral of Implementation Date of SFFAS No. 4*. • SFFAS 30, *Inter-Entity Cost Implementation*, rescinds par. 110 and amends par. 111 of SFFAS 4. • SFFAS 55, *Amending Inter-Entity Cost Provisions,* rescinds SFFAS 30 which restored par. 110 and 111. SFFAS 55 then amends par. 110 and 111 and also added new disclosures in par. 113A.
Related Guidance	Interpretation 2, *Accounting for Treasury Judgment Fund Transactions* TR 1, *Audit Legal Letter Guidance* Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*.

Summary

The managerial cost accounting concepts and standards contained in this statement are aimed at providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The concepts of managerial cost accounting contained in this statement describe the relationship among cost accounting, financial reporting, and budgeting. The five standards set forth the fundamental elements of managerial cost accounting.

Managerial Cost Accounting Concepts

Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition, and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other.

Managerial Cost Accounting Standards

Requirement for cost accounting - Each reporting entity should accumulate and report the costs of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

Responsibility segments - Management of each reporting entity should define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should be performed to determine the costs of outputs.

Full cost - 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.

Inter-entity costs - 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 generally should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity.

Costing methodology - Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. 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.

The cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

Table of Contents

Executive Summary

1. The managerial cost accounting concepts and standards contained in this statement are aimed at providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The cost information can be used by the Congress and federal executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance. The cost information can also be used by program managers in making managerial decisions to improve operating economy and efficiency.

2. The concepts of managerial cost accounting contained in this statement describe the relationship among cost accounting, financial reporting, and budgeting. The five standards set forth the fundamental elements of managerial cost accounting: (1) accumulating and reporting costs of activities on a regular basis for management information purposes, (2) establishing responsibility segments to match costs with outputs, (3) determining full costs of government goods and services, (4) recognizing the costs of goods and services provided among federal entities, and (5) using appropriate costing methodologies to accumulate and assign costs to outputs.

3. These standards are based on sound cost accounting concepts and are broad enough to allow maximum flexibility for agency managers to develop costing methods that are best suited to their operational environment. Also, the managerial cost accounting standards and practices will evolve and improve as agencies gain experience in using them. The following is a summary of the concepts and standards contained in this statement.

Managerial Cost Accounting Concepts

4. Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition, and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other.

Managerial Cost Accounting Standards

Requirement for cost accounting

5. Each reporting entity should accumulate and report the costs of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

Responsibility segments

6. Management of each reporting entity should define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should be performed to determine the costs of outputs.

Full cost

7. 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.

Inter-entity costs

8. 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.

9. 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 generally should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity.

Costing methodology

10. Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. 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.

11. The cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable. (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

12. These accounting standards need not be applied to items that are qualitatively and quantitatively immaterial. The Board recommends that the managerial accounting standards of this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

Introduction

Background

13. Reliable information on the costs of federal programs and activities is crucial for effective management of government operations. In Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, Objectives of Federal Financial Reporting, issued in 1993, it is stated that the objectives of federal financial reporting are to provide useful information to assist internal and external users in assessing the budget integrity, operating performance, stewardship, and systems and control of the federal government.[1]

14. Managerial cost accounting is especially important for fulfilling the objective of assessing operating performance. In relation to that objective, it is stated in SFFAC No. 1 that federal financial reporting should provide information that helps users to determine:

- Costs of specific programs and activities and the composition of, and changes in, those costs;
- Efforts and accomplishments associated with federal programs and their changes over time and in relation to costs; and
- Efficiency and effectiveness of the government's management of its assets and liabilities.[2]

15. It is further stated in SFFAC No. 1 that "The topics of costs and performance measurement are related because it is by associating cost with activities or cost objectives that accounting can make much of its contribution to reporting on performance."[3] "Cost" is 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. Costs incurred may benefit current and future periods. In financial accounting and reporting, the costs that apply to an entity's operations for the current accounting period are recognized as expenses of that period.

[1]Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting* (September 2, 1993), pars. 110 and 111.

[2]Ibid., pars. 126-130.

[3]Ibid., par. 192.

16. The Chief Financial Officers Act of 1990 includes among the functions of chief financial officers “the development and reporting of cost information” and “the systematic measurement of performance.”[4] In July 1993, Congress passed the Government Performance and Results Act (GPRA) which mandates performance measurement by federal agencies.[5] In September 1993, in his report to the President on the National Performance Review (NPR), Vice President Al Gore recommended an action which required the Federal Accounting Standards Advisory Board to issue a set of cost accounting standards for all federal activities.[6] Those standards will provide a method for identifying the unit cost of all government activities.

17. In early 1994, the Federal Accounting Standards Advisory Board (the Board) convened an advisory group to help develop standards for managerial cost accounting in the federal government. The group included members from government, business, and academe. Their views and proposals have been considered by the Board, and their work contributed greatly in developing this document.

Users Of Federal Cost Information

18. The cost of government is a concern to the public as well as to the federal government itself. Most government service efforts and accomplishments cannot be measured in financial terms alone. Unlike private business, there is no “bottom line” or profit index to help measure public sector performance. However, government service efforts and accomplishments can be evaluated using both financial and non-financial measures, and “cost” is an important financial measure for government programs. Internal and external federal information users identified below will find these standards helpful in assessing operating performance, stewardship, systems, and control of the federal government.

19. *Government managers* are the primary users of cost information. They are responsible for carrying out program objectives with resources entrusted to them. Reliable and timely cost information helps them ensure that resources are spent to achieve expected results and outputs, and alerts them to waste and inefficiency.

20. *Congress and federal executives*, including the President, make policy decisions on program priorities and allocate resources among programs. These officials need cost

[4]104 Stat. 2938 (See particularly 31 U.S.C. sec 902).

[5]107 Stat. 285 (See particularly, 31 U.S.C. sections 1101, 1105, 1115, 1116-1119, 9703, 9704).

[6]Vice President Al Gore, Creating A Government That Works Better & Costs Less, Accompanying Report of the National Performance Review (September 1993), p. 59.

information to compare alternative courses of action and to make program authorization decisions by assessing costs and benefits. They also need cost information to evaluate program performance.

21. *Citizens*, including news media and interest groups, are concerned with the costs and results of federal programs that affect their interests. They need program cost information to judge whether resources are allocated to programs rationally and if the programs operate efficiently and effectively.

Objectives

22. The managerial cost accounting concepts and standards presented here are intended for all the user groups identified above. These standards are aimed at achieving three general objectives:

- Provide program managers[7] with relevant and reliable information relating costs to outputs and activities. Based on this information, program managers can respond to inquiries about the costs of the activities they manage. The cost information will assist them in improving operational economy and efficiency;
- Provide relevant and reliable cost information to assist the Congress and executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance; and
- Ensure consistency between costs reported in general purpose financial reports and costs reported to program managers. This includes standardizing terminology for managerial cost accounting to improve communication among federal organizations and users of cost information.

Scope Of Standards

23. This statement contains managerial cost concepts and five standards for the federal government. The five standards address the following topics:

(1) Requirement for cost accounting,
(2) Responsibility segments,
(3) Full cost,

[7]Statement of Federal Financial Accounting Concepts No. 1, Objectives of Financial Reporting, defined “Program managers” as individuals who manage federal programs, and stated that “Their concerns include operating plans, program operations, and budget execution.” SFFAC No. 1, par. 85.

(4) Inter-entity costs, and
(5) Costing methodology.

The essence of each standard is briefly stated in a box followed by detailed explanations. **However, both the words in the boxes and the entire text of explanations constitute the requirements of the standards.**

24. These standards are based on sound cost accounting concepts and allow sufficient flexibility for agencies to develop managerial cost accounting practices that are suited to their specific operating environments. Also, it is expected that cost accounting standards and practices will evolve and improve as agencies gain experience in using them.

25. Other Statements of Federal Financial Accounting Standards (SFFAS) address recognition and measurement of assets and liabilities. For additional guidance, readers should consult: SFFAS No. 1, *Accounting for Selected Assets and Liabilities*; SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*; and SFFAS No. 3, *Accounting for Inventory and Related Property*. The Board is working on and will soon complete other recognition and measurement projects related to revenues, liabilities, property, plant, and equipment, and other elements of financial statements.[8]

Terminology

26. Managerial cost accounting information, to be useful, must rely on consistent and uniform terminology for concepts, practices, and techniques. Consistent and uniform use of terminology can help avoid confusion and mis-communication among organizations and individuals.

27. As a start toward developing consistent managerial cost accounting terminology within the federal government, this statement includes a glossary of basic cost accounting terms.

Materiality

28. Except as otherwise noted, the accounting and reporting provisions of these accounting standards need not be applied to items that are qualitatively or quantitatively immaterial.

[8]See FASAB Exposure Drafts, *Accounting for Liabilities of the Federal Government* (November 7, 1994); *Accounting for Property, Plant, and Equipment* (February 28, 1995); and *Revenue and Other Financing Sources* (Pending).

29. The determination of whether an item is material depends on the degree to which omitting 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.

Effective Date

30. 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.

Purposes Of Using Cost Information

31. There are many different purposes for which cost information may be used by the federal government. The focus of this statement is on cost information needed to improve federal financial management and managerial decision making.

32. In managing federal government programs, cost information is essential in the following five areas: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees and prices, (4) program evaluations, and (5) making economic choice decisions. Each of these uses is discussed below.

Budgeting And Cost Control

33. Information on the costs of program activities can be used as a basis to estimate future costs in preparing and reviewing budgets. Once budgets are approved and executed, cost information serves as a feedback to budgets. Using cost information, federal managers can control and reduce costs, and find and avoid waste. For example, with appropriate cost information, federal managers can:

- Compare costs with known or assumed benefits of activities, identify value-added and non-value-added activities, and make decisions to reduce resources devoted to activities that are not cost-effective;
- Compare and determine reasons for variances between actual and budgeted costs of an activity or a product;
- Compare cost changes over time and identify their causes;
- Identify and reduce excess capacity costs; and
- Compare costs of similar activities and find causes for cost differences, if any.

Performance Measurement

34. 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."

35. 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.

36. Thus, as stated previously, performance measurement requires both financial and non-financial measures. Cost is a necessary element for performance measurement, but is not the only element.

Determining Reimbursements And Setting Fees And Prices

37. Cost information is an important basis in setting fees and reimbursements. Pricing and costing, however, are two different concepts. Setting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies. Thus, the price of a good or service does not necessarily equal the cost of the good or the service determined under a particular set of principles. Nevertheless, cost is an important consideration in setting government prices. With certain exceptions, OMB requires:[9]

[9]OMB Circular A-25, User Charges (Revised July 8, 1993).

- With respect to goods and services that the government provides in its sovereign capacity to a particular group of individuals as a special benefit, user charges should be sufficient to recover the full cost of those goods and services; and
- With respect to goods and services that the government provides under business-like conditions, user charges for those goods and services need not be limited to the recovery of full cost and may yield a net revenue.

38. Also, cost information is important in calculating reimbursements for products and services provided by one government agency to another. Even if fees or reimbursements do not recover the full costs due to policy or economic constraints, management needs to be aware of the difference between cost and price. With this information, program managers can properly inform the public, the Congress, and federal executives about the costs of providing the goods or services.

Program Evaluations

39. Costs of federal resources required by programs are an important factor in making policy decisions related to program authorization, modification, and discontinuation. These decisions are usually subject to policy constraints, and often require the consideration of social and economic costs and benefits affecting different sectors of the economy and society. Nevertheless, the costs of federal resources required are an important factor. Information on program costs can be used as a basis for cost-benefit considerations.

Economic Choice Decisions

40. Often, agencies and programs face decisions involving choices among alternative actions, such as whether to do a project in-house or contract it out; to accept or reject a proposal; or to continue or drop a product or service. Making these decisions requires cost comparisons among available alternatives.

Managerial Cost Accounting Concepts

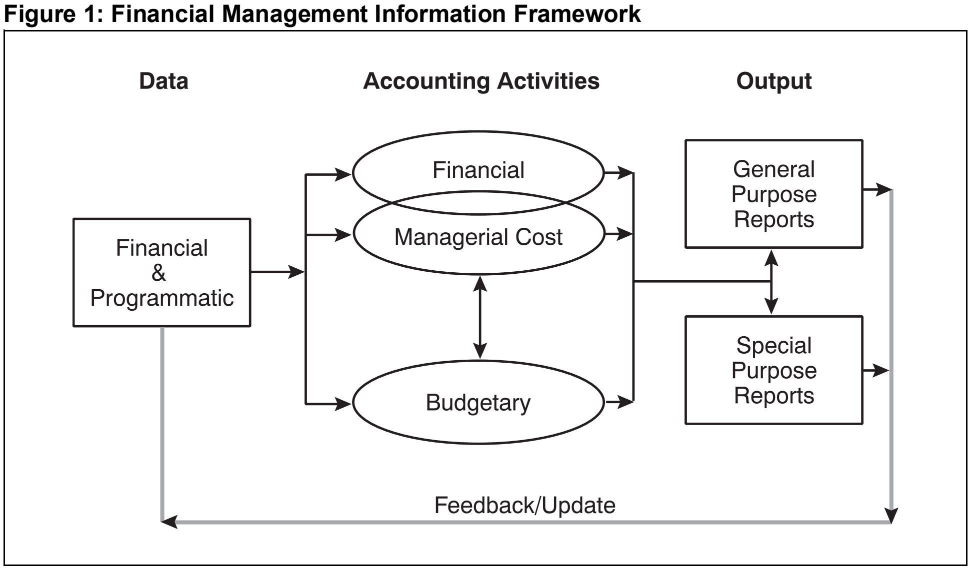
Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition, and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other.

41. Managerial cost accounting should be an essential element of proper financial planning, control, and evaluation for any organization or activity that uses resources having monetary value. Managerial cost accounting is a basic part of the financial management system in that it supports and provides data to the budgetary and financial accounting functions and, by itself, provides useful information for both internal and external users.

Role Of Managerial Cost Accounting In Financial Management

42. Managerial cost accounting is the process of accumulating, measuring, analyzing, interpreting, and reporting cost information useful to both internal and external groups concerned with the way in which the organization uses, accounts for, safeguards, and controls its resources to meet its objectives. Managerial cost accounting, therefore, is the servant of both budgetary and financial accounting and reporting because it assists those systems in providing information. Also, it provides useful information directly to management. These relationships are shown in Figure 1.

Figure 1: Financial Management Information Framework



Common Data Source

43. The information flow within a financial management system begins with a basic information pool or common data source. This data source consists of all financial and programmatic information used by 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.[10] The common data source also includes evaluation and decision information developed as a result of prior reporting and feedback. Other types of data may be included based upon perceived needs and purposes related to the ultimate users of the information.

44. The common data source may include many different kinds of data. It is far more than the information about financial transactions found in the standard general ledger, although that is a significant part of the data source. Few organizations or entities maintain all these data in any one system or location. Furthermore, the use of the term "data source" is not meant to imply the use of computerized systems for source information. Instead, the term is used in a broad way to include many sources of information.

45. Managerial cost accounting, financial accounting, and budgetary accounting draw information as needed from the common data source. The data obtained by each of these is processed to attain specific objectives by reporting useful information.

Relationship to Financial Accounting

46. As shown in Figure 1 by their overlap, managerial cost accounting and financial accounting are closely related or integrated. To some degree, this is due to the historical development of cost accounting as a method for more detailed scorekeeping with the requirement to provide inventory values for external financial reporting purposes.[11] In part, it is because cost information generally originates with transactions recorded for financial accounting purposes.

47. While inventory valuation is still part of the fundamental relationship, managerial cost accounting serves financial accounting in several other ways. Fundamentally, managerial cost accounting should assist financial accounting in determining the results of operations during a fiscal period by providing relevant data that are accumulated to produce operating expenses. These data include the allocation of capitalized costs to periods of time or units of usage.

48. Traditionally, managerial cost accounting information pertaining to financial accounting has involved costs of past transactions and the assignment of transaction value to fiscal periods

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[10]The makeup of core data and environmental data is discussed in Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, Chapter 7, and, therefore, a detailed discussion is not provided here.

[11]Coulthurst, Nigel and John Piper, "The State of Cost and Management Accounting," Management Accounting, April 1986.

and outputs. These purposes and uses are closely aligned with the financial accounting activity and traditional external financial reporting. This past cost aspect has been acknowledged in *Objectives of Federal Financial Reporting* which states that "financial accounting is largely concerned with assigning the value of past transactions to appropriate time periods."[12]

Relationship to Budgetary Accounting

49. Managerial cost accounting should also provide budgetary accounting with cost information. However, the two are not as closely aligned as is the case with financial accounting (see Figure 1). Mostly, this is because costs are usually recorded, accumulated, and allocated by managerial cost accounting on an accrual basis of accounting which is different from the obligation or cash basis generally used in budgetary accounting.

50. Still, managerial cost accounting does provide cost information to budgetary accounting for use in preparing yearly and long-term budgets for required materials, supplies, equipment, human resources, and other resources needed to produce different levels of outputs. Managerial cost accounting also helps in making many budgetary decisions such as those concerning future capital expenditures and purchase/lease alternatives.

51. It is important to note that the Board's authority does not extend to recommending budgetary standards or budgetary concepts, and that is not the purpose of this statement.[13] However, the Board is committed to providing relevant and reliable cost accounting information that supports budget planning, formulation, and execution.

Cost Information for Management Purposes

52. Managerial cost accounting produces information directly for management use, sometimes employing data produced by the budgetary and financial accounting processes. Cost information is used for many different purposes which can be generally classified into five types: performance measurement; cost reduction and control; determination of reimbursements and fee or price setting; program authorization, modification, and discontinuation decisions; and decisions to contract out work or make other changes in the methods of production.

53. To meet these needs, managerial cost accounting should use basic cost data and non-financial or programmatic data. For example, it tracks units of output produced and input

[12]Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, par. 168.

[13]Memorandum of Understanding establishing the FASAB, October 10, 1990.

used including the amount of labor in terms of employees or employee-hours. Sometimes, information from cost analysis is used to compare actual to predetermined or anticipated costs. An organization may use cost estimates, cost studies, and cost finding techniques.

54. While managerial cost accounting is concerned not only with past costs and future costs, one of its most important features is the use of present costs to assist management. This current cost aspect of managerial cost accounting is referred to in the *Objectives of Federal Financial Reporting* where is states that “accounting data may be further assigned, allocated, or associated with units of activity or production, segments of organizations, etc., within the same time period. These kinds of intraperiod allocations are developed most extensively in the branch of accounting called cost accounting. Neither the FASB nor the GASB has devoted much attention to this branch of accounting, but the FASAB, because of its unique mission, will need to do so.”[14] Managerial cost accounting information pertaining to present costs is most often used for controlling and reducing those costs, controlling work processes, and measuring current performance.

Reporting Relationships

55. Proper financial management requires that the three accounting processes work closely together to provide useful reporting to both internal and external users. The internal-external dual focus of federal reporting has been established in the *Objectives of Federal Financial Reporting*. It states that “The FASAB and its sponsors believe that any description of federal financial reporting objectives should consider the needs of both internal and external users and the decisions they make.” In addition, it says that “the FASAB... considers the information needs of both internal and external users. In part, this is because the distinction between internal and external users is in many ways less significant for the federal government than for other entities.” It goes on to classify the users of financial information into four major groups: program managers, executives, the Congress, and citizens.[15] These categories include both internal and external users.

56. Federal financial reporting encompasses general and special purpose reports to meet the needs of the four user groups. Information produced by managerial cost accounting appears in or influences both types of reports.[16] As discussed above, managerial cost accounting should provide information for use by both financial accounting and budgetary accounting.

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[14]Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, par. 174.

[15]Ibid., pars. 23, 25, and par. 75.

[16]The types of general purpose and special purpose reports are discussed in Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting, Chapter 7.

That information is used by those processes in producing both general purpose and special purpose reports.

57. Managerial cost accounting also results in reports of its own. Most often these are special purpose reports designed for internal users, typically program and line managers. However, they may be for groups generally considered external users.

58. One of the most important aspects of reporting in which managerial cost accounting plays a large role is that of performance reporting. Measuring and reporting actual performance against established goals is essential to assess governmental accountability. Cost information is necessary in establishing strategic goals, measuring service efforts and accomplishments, and relating efforts to accomplishments. The importance of cost information in relation to performance measurement and performance reporting has been recognized in the *Objectives of Federal Financial Reporting*, which said "One reason for performing cost accounting is to assist in performance measurement" and it also stated that "The topics of cost and performance measurement are related because it is by associating cost with activities or 'cost objectives' that accounting can make much of its contribution to reporting on performance."[17]

Basis Of Accounting And Recognition/measurement Methods

59. Costs may be measured, analyzed, and reported in many ways. A particular cost measurement has meaning only when considering its purpose. The measurement of costs can vary depending upon the circumstances and purpose for which the measurement is to be used. In *Objectives of Federal Financial Reporting*, it is stated that "the Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a <u>variety of measures of costs</u> and other information that complements the information available in the budget [emphasis added]."[18]

60. In addition, it is stated that "In defining the proper measurement, assignment, and allocation of cost for a given purpose, selecting the appropriate accounting method and whether to use full costing should be carefully considered."[19] Further, it added that "The accrual basis of

[17]Ibid., par. 174 and par. 192.

[18]Ibid., par. 191.

[19]Ibid., par. 196.

accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated."[20]

61. Therefore, managerial cost accounting should provide cost information using a basis of accounting and recognition/measurement standards that are appropriate for the intended use of the information. When managerial cost accounting is used to supply information for use by financial accounting and financial reporting, that information should be consistent with the basis of accounting and recognition/measurement standards required by federal accounting principles. Traditionally this has meant the use of accrual accounting and historical cost measurement, particularly in general purpose reports.

62. When managerial cost accounting is used to supply information for the preparation and review of budgets, cost data should be consistent with the basis of accounting and recognition/measurement used in financial reporting, but may be adjusted to meet the budgetary information needs.

63. Special purpose cost studies and analyses are sometimes performed for decision making. In those studies and analyses, management may need to develop cost data beyond those currently reported in general purpose financial reports. For example, in making planning decisions, management may develop replacement costs and capital costs. However, the basis and methods used should be appropriate for the circumstances and consistent with the intended purposes.

Reconciliation Of Information

64. Different bases of accounting will produce different costs for the same item, activity, or entity. This can confuse users of cost information. Therefore, reports that use different accounting bases or different recognition and measurement methods should be reconcilable, and should fully explain those bases and methods. Regardless of the type of report in which it is presented, cost information should ultimately be traceable back to the original common data source.

65. To be reconcilable, the amount of the differences in the information reported should be ascertainable and the reasons for the differences should be explainable. In some situations, informational differences may be clearly understandable without further explanation. However, other cases may require a narrative statement concerning the differences. In complicated situations, a schedule or table may be required to fully explain the differences.

[20] Ibid., par. 197.

66. Financial reporting has long recognized the necessity for reconciliation between information reported on different accounting bases. Reconciliations have been required in federal financial reports to show and explain significant differences between budget reports and financial statements prepared in accordance with generally accepted accounting principles.

Managerial Cost Accounting Standards

Requirement For Cost Accounting

Each reporting entity[21] should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

67. Cost information is essential to effective financial management and should play an important role in federal financial reporting. Managerial cost accounting processes are the means of providing cost information in an efficient and reliable manner on a continuing basis.

Need For Consistent Cost Accounting On A Regular Basis

68. To perform managerial cost accounting on a "regular basis" means that entities should establish procedures to accumulate and report costs continuously, routinely, and consistently for management information purposes. Consistent and regular cost accounting is needed to meet the second objective of federal financial reporting which states information should be provided to help the user determine the costs of providing specific programs and activities and the composition of, and changes in those costs. That objective also requires the reporting of performance information of federal programs and the changes over time in that performance in relation to the costs.

69. The requirement for managerial cost accounting on a regular and consistent basis supports recent legislative actions. The CFO Act of 1990 states that agency CFOs shall provide for the development and reporting of cost information and the periodic measurement of performance. In addition, the GPRA of 1993 requires each agency, for each program, to establish performance indicators and measure or assess relevant outputs, service levels, and outcomes of each program as a basis for comparing actual results with established

[21]The term "reporting entity" as used in this document conveys the same meaning as defined in FASAB Statement of Recommended Accounting Concepts No. 2, *Entity and Display* (May 1995).

goals. The nature of these legislative mandates requires reporting entities to develop and report cost information on a consistent and regular basis.

70. The managerial cost accounting processes consist of collecting data from the common data source, processing that data, and reporting cost and output information in general purpose and special purpose reports. Appropriate procedures and practices should also be established to enable the collection, measurement, accumulation, analysis, interpretation, and communication of cost information. This can be accomplished through the use of a cost accounting system or the use of cost finding techniques and other cost studies and analyses. A cost accounting "system" is an organized grouping of methods and activities designed to consistently produce reliable cost information.

Basic Cost Accounting Processes

71. Regardless of whether a reporting entity uses a cost accounting system or cost finding techniques, the methods and procedures followed should be designed to perform at least a certain minimum level of cost accounting and provide a basic amount of cost information necessary to accomplish the many objectives associated with planning, decision making, control, and reporting. The more important of these minimum criteria for cost accounting are associated with the standards in the remainder of this statement. Others are also important.

- Responsibility Segments - Cost information should be collected by responsibility segments which have been identified by management and outputs should be defined for each responsibility segment.[22]
- Full Costing - Each reporting entity should measure the full cost of outputs so that total operational costs and total unit costs of outputs can be determined. "Full cost" includes the cost of goods or services provided by other entities when the applicable criteria are met.[23]
- Costing Methodology - The costing methodology used (e.g., activity-based costing, job order costing, standard costing, etc.) should be appropriate for management's needs and the operating environment.[24]
- Performance Measurement - Cost accounting should provide information needed to determine and report service efforts and accomplishments and information necessary to meet the requirements of the GPRA or interface with a system that provides such

[22]See standard in this statement concerning responsibility segments.

[23]See standard concerning full costs and standard concerning inter-entity costing.

[24]See standard concerning costing methodology.

information. This includes the quantity of inputs and outputs and other non-financial information needed in the measurement of performance.

- Reporting Frequency - Cost information should be reported in a timely manner and on a regular basis consistent with the needs of management and the requirements of both budgetary and financial reporting.
- Standard General Ledger - Managerial cost accounting should be integrated with general financial accounting. Both depend on the standard general ledger for basic financial transaction data.
- Precision of Information - Cost information supplied to internal and external users should be reliable and useful in making evaluations or decisions. At the same time, unnecessary precision and refinement of data should be avoided.
- Special Situations - The managerial cost accounting processes should be designed to accommodate any of management's special cost information needs that may arise due to unusual or special situations or circumstances. If such cost information is needed on a regular basis, appropriate procedures to provide it should be developed.
- Documentation - All managerial cost accounting activities, processes, and procedures should be documented by a manual, handbook, or guidebook of applicable accounting operations. This reference should outline the applicable activities, provide instructions for procedures and practices to be followed, list the cost accounts and subsidiary accounts related to the standard general ledger, and contain examples of forms and other documents used.

Complexity Of Cost Accounting Processes

72. While each entity's managerial cost accounting should meet the basics discussed above, this standard does not specify the degree of complexity or sophistication of any managerial cost accounting process. Each reporting entity should determine the appropriate detail for its cost accounting processes and procedures based on several factors. These include the:

    - nature of the entity's operations;
    - precision desired and needed in cost information;
    - practicality of data collection and processing;
    - availability of electronic data handling facilities;
    - cost of installing, operating, and maintaining the cost accounting processes; and
    - any specific information needs of management.

73. Some entities may find that they can purchase basic "off-the-shelf" cost accounting programs, systems, or processes, or adapt those of other federal agencies. All entities should consider using similar or compatible cost accounting processes throughout their component units to facilitate comparison and consolidation of cost information.

Cost Findings, Studies, And Analyses

74. A cost accounting system is a continuous and systematic cost accounting process which may be designed to accumulate and assign costs to a variety of objects routinely or as desired by the management. Such a system may be best for some reporting entities.

75. Some entities may not need a sophisticated system to perform detailed cost accumulation and assignment. They need to accumulate and report costs regularly as required by this standard, but they may determine and analyze costs through special cost studies and analyses. Also, some entities may use a combination of a system supplemented by cost studies.

76. Cost information may be developed and savings achieved in some cases by the use of special cost studies or cost analyses to develop information helpful in certain decision making situations. In addition, cost finding techniques may be used to determine the cost of products or services. Cost finding is a method for determining the cost of producing goods or services using appropriate procedures. Cost finding techniques may also be useful for computing costs in cases where the information is not needed on a recurring basis.

Responsibility Segments

Management of each reporting entity should define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should also be performed to determine the costs of outputs.

77. The standard states that the management of each reporting entity should define and establish responsibility segments. This section explains the concept of responsibility segment, purposes of segmentation, and how responsibility segments can be structured.

Defining Responsibility Segments

78. A responsibility segment is a component of a reporting entity[25] that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services. In addition, responsibility segments usually possess the following characteristics:

    (1) Their managers report to the entity's top management directly;

[25]The term "reporting entity" referred to in this document conveys the same meaning as defined in FASAB Statement of Recommended Accounting Concepts No. 2, *Entity and Display* (May 1995).

(2) Their resources and results of operations can be clearly distinguished from those of other segments of the entity.[26]

79. A responsibility segment is a unit for which managerial cost accounting is performed. Entities may use a centralized accounting system or segment-based systems to provide cost information for each segment. For each segment, managerial cost accounting should:

(1) Define and accumulate outputs, and if feasible, quantify each type of output in units;

(2) Accumulate costs and quantitative units of resources consumed in producing the outputs; and

(3) Assign costs to outputs, and calculate the cost per unit of each type of output.

80. Some reporting entities may have only one responsibility segment, if they perform one single mission or one type of service. Other reporting entities may have several responsibility segments. Also, a sub-organization of the federal government may be a reporting entity in itself and, at the same time, it may also be a responsibility segment of a higher level reporting entity to which it belongs. The Forest Service, for example, may be a reporting entity because it may meet the reporting entity criteria. As such, it may establish responsibility segments for itself. At the same time, the Forest Service may be regarded as a responsibility segment of the Department of Agriculture, of which it is a component.

81. However, for a given reporting entity, its management should establish one or more responsibility segments to perform managerial cost accounting functions.

Purposes Of Segmentation

82. A basic purpose of dividing an entity into segments is to determine and report the costs of services and products that each segment produces and delivers. Many federal departments and agencies manage programs that produce a variety of goods and services. Accounting for entity-wide revenues and expenses in aggregate would serve financial reporting for the entity, but would not serve costing purposes. In order to determine the cost of each type of service or product, it is necessary to divide an entity into segments such that each segment is responsible for certain types of services or products. Each segment can then be used as a vehicle for accumulating costs incurred by the segment to match with its outputs. Each segment can use a cost methodology that is best suited to its operations.

[26]These two characteristics make responsibility segments, as the term is used in this document, differ from cost centers. A cost center can be at any level of an organization and may not report to the top management directly. As will be explained later, a responsibility segment can contain cost centers in itself.

83. Another important purpose of segmentation is to facilitate cost control and management. Cost information provided for each segment helps managers to examine costs of specific resources consumed and activities performed in each segment. Managers can analyze cost variances in both dollars and the units of resources consumed against budgets or standards. Since each segment performs a particular pattern of processes and activities to produce its output, managers can analyze those processes and activities to compare their costs with the value they contribute to the output.

84. For entities that consist of components engaging in diverse lines of activities, it is desirable to provide financial reports that display information for significant components individually and of the entity in its entirety.[27] Some entities may find costs accumulated by segments useful in support of financial reporting by components.

85. For internal management, segmentation could also facilitate performance measurement. Since each segment is responsible for a mission, or a line of activity to produce a certain type of output, performance goals can be set for each segment based on its specific tasks and operating patterns. Information on costs, outputs, and outcomes related to each segment can be used to measure its performance against the goals. The results of the segment performance measurement could also support external reporting on performance measures for the entire reporting entity or its major programs.

Structuring Responsibility Segments

86. Reporting entity management should define and structure its responsibility segments. The designation of responsibility segments should be based on the following factors: (a) the entity’s organization structure, (b) its lines of responsibilities and missions, (c) its outputs (goods or services it delivers), and (d) budget accounts and funding authorities. However, the predominant factor is the reporting entity’s organization structure and its existing responsibility components, such as bureaus, administrations, offices, and divisions within a department.

87. The U.S. General Services Administration, for example, provides five distinct services: (1) managing public buildings, (2) distributing supplies, (3) providing travel and transportation services, (4) managing information resources (including communication and data processing services), and (5) disposal of real properties. Each of those service areas could be designated as a responsibility segment. The Department of Veterans Affairs (VA), among its other services, provides health care to veterans, pays veterans’ compensation and

[27] This point is discussed in FASAB Statement of Recommended Accounting Concepts No. 2, *Entity and Display*, pars. 75-76.

pension benefits, and provides home loans and home loan guarantees to veterans. Each of these program areas could constitute a responsibility segment.

88. Since responsibility segments are major parts of an entity, some segments may carry more than one program. Some programs may be jointly managed by two or more segments. Thus, each segment must accumulate costs for each type of output produced for various programs. To accomplish this, a network of cost centers can be established within a segment to accumulate costs. Managers of each cost center will be provided with information to control and manage costs within their area of responsibility. Depending on operational patterns and cost methods, cost centers can be structured along different dimensions, such as organizational units, operating processes, and activities.

Full Cost

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.

89. This standard states that reporting entities should measure and report the full costs of their outputs in general purpose financial reports. “Outputs” means products and services generated from the consumption of resources. 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. The standard does not require full cost reporting in federal entities’ internal reports or special purpose cost studies. Entity management can decide on a case-by-case basis whether full cost is appropriate and should be used for internal reporting and special purpose cost studies.

Direct Costs

90. Direct costs are costs that can be specifically identified with an output. All direct costs should be included in the full cost of outputs. Typical direct costs in the production of an output include:

(a) Salaries and other benefits for employees who work directly on the output;

(b) Materials and supplies used in the work;

(c) Various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output; and

(d) Costs of goods or services received from other segments or entities that are used to produce the output (See discussions and explanations in the next section on "Inter-Entity Costs").

Indirect Costs

91. Indirect costs are costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include costs of general administrative services, general research and technical support, security, rent, employee health and recreation facilities, and operating and maintenance costs for buildings, equipment, and utilities. There are two levels of indirect costs:

    (a) Indirect costs incurred within a responsibility segment. These indirect costs should be assigned to outputs on a cause-and-effect basis, if such an assignment is economically feasible, or through reasonable allocations. (See discussions on cost assignments in the "Costing Methodology" section.)

    (b) Costs of support services that a responsibility segment receives from other segments or entities. The support costs should be first directly traced or assigned to various segments that receive the support services. They should then be assigned to outputs.

92. A reporting entity and its responsibility segments may incur general management and administrative support costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization costs, and they should be reported on the entity's financial statements (such as the Statement of Net Costs) as costs not assigned to programs.[28]

Certain Cost Elements

Costs of Employees' Benefits

93. Employee benefits include:

[28] A similar explanation is provided in FASAB Statement of Recommended Accounting Concepts No. 2, *Entity and Display*, par. 95.

(a) Health and life insurance benefits for current employees covered in part by the government's contribution to health and life insurance premiums;

(b) Pension benefits for employees, their survivors, and dependents, covered by defined pension plans such as Civil Service Retirement System (CSRS), Federal Employees Retirement Plan (FERS), and Military Retirement System (MRS);

(c) Health and life insurance benefits for retired employees, their survivors and dependents, covered in part by the government's contribution to health and life insurance premiums, and referred to as "other retirement benefits" (ORB) in this document;

(d) Other postemployment benefits (OPEB) for terminated and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and workers compensation.

94. Most of the employee benefit programs are covered by trust funds administered by the Office of Personnel Management (OPM) and the Department of Defense (DoD). Contributions to the trust funds come from three sources: current and retired employees, employing agencies, and direct appropriations. The management expenses of the trust funds are paid with the funds' receipts.

95. Federal financial accounting standards require that the employing entity accrue the costs to the federal government of providing pension and ORB benefits to employees and recognize the costs as an expense when the benefits are earned.[29] The employing entity should recognize those expenses regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds. This principle should also be applied to health and life insurance benefits for current employees and comparable benefits for military personnel. The costs of employee benefits incurred by responsibility segments should be directly traced or assigned to outputs.

96. OPEB costs include severance payments, counseling and training, health care, and workers compensation benefits paid to former or inactive employees. OPEB costs are often incurred as a result of such events as reductions in force or on-the-job injuries of employees. Federal financial accounting standards require that OPEB costs be reported as an expense for the period during which a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the accounting date.[30]

[29]FASAB Exposure Draft, *Accounting for Liabilities of the Federal Government* (November 7, 1994), pars. 62-99.

[30]Ibid., pars. 100-102.

97. Since the recognition of OPEB costs is linked to the occurrence of an OPEB event rather then the production of output, in many instances, assigning OPEB costs recognized for a period to output of that period would distort the cost of output. In special purpose cost studies or cost findings, management may distribute OPEB costs over a number of years in the past to determine the costs of the outputs that the OPEB recipients helped to produce.

Costs of Public Assistance and Social Insurance Programs

98. Major costs of welfare, insurance, and grant programs are the costs of resources transferred from the federal government to individuals and state and local governments. Some of them are referred to as “transfer payments.” The following are some typical public assistance and insurance programs:

- Grants, such as aid to state and local governments;
- Subsidies, such as agricultural commodity price support and stabilization programs;
- Credit and insurance costs, such as the Family Education Loan Program and Savings Association Insurance;
- Welfare payments such as Aid to Families with Dependent Children (AFDC); and,
- Social insurance, such as the Old Age, Survivors, and Disability Insurance Program.

99. The full cost of such a program includes: (a) the costs of federal resources that have been or will be transferred to individuals and state/local governments, and (b) the costs of operating the programs. These two types of costs should be recognized on a basis of accounting that is prescribed within the Federal Financial Accounting Standards. These two types of costs should be separately identified so that each can be used for different analytic purposes.

100. The costs resulting from transfer payments are determined by the level of grants, subsidies, entitlement benefits, credit subsidies, or loss payments made under insurance and guarantee agreements. They are also determined by the number of eligible persons who receive the transfer payments. The program cost of AFDC, for example, depends on the average payment per family, the number of eligible families, and the federal government’s share in the payments (some payments are made by state and local governments). Information on this type of cost is useful for making policy decisions about levels of subsidies or benefits, eligibility of recipients, and how transfer payments are made. This cost information is also useful for measuring the cost-effectiveness of a transfer payment program.

101. Program operating costs, on the other hand, are costs of managing the program and delivering the payments. They include the costs of personnel, supplies, equipment, and offices. The costs are related to such activities as screening benefit recipients for eligibility,

keeping their accounts, making payments and collections, answering inquiries, etc. Information on this type of cost is useful in measuring the efficiency of program operations.

Costs related to Property, Plant and Equipment

102. **Depreciation expense.** General property, plant, and equipment are used in the production of goods and services. Their consumption is recognized as depreciation expense. The depreciation expense incurred by responsibility segments should be included in the full costs of the goods and services that the segments produce.

103. **Recognizing property acquisition costs as expenses.** The costs of acquiring or constructing federal mission and heritage property, plant, and equipment may be charged to expenses at the time the acquisition costs are incurred.[31] Since the recognition of these expenses is linked to property acquisition rather than production of goods and services, those expenses should not be included in the full costs of goods and services. However, they are part of the costs of the entity or the program that makes the property acquisitions.

Non-production costs

104. A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. Two examples of these non-production costs were discussed earlier: (1) OPEB costs that are recognized as expenses when an OPEB event occurs, and (2) certain property acquisition costs that are recognized as expenses at the time of acquisition. Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that are not accrued. Since these costs are recognized for a period in which a particular event occurs, assigning these costs to goods and service produced in that period would distort the production costs. In special purpose cost studies, management may have reasons to determine historical output costs by distributing some of these costs to outputs over a number of past periods. Such distribution may be appropriate when: (a) experience shows that the costs are recurring in a regular pattern, **and** (b) a nexus can be established between the costs and the production of outputs that may have benefited from those costs.

[31] In FASAB Exposure Draft, Accounting for Property, Plant, and Equipment, the Board proposed that the costs of acquiring or constructing “federal mission” and “heritage” property, plant, and equipment be recognized as expenses when the costs are incurred. See the ED, pars. 98-117, pages 29-34.

Inter-entity Costs

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.

105. As stated in the preceding standard, to fully account for the costs of the goods and services they produce, reporting entities should include the cost of goods and services received from other entities. Knowledge of these costs is helpful to top level management in controlling and assessing the operating environment. It is also helpful to other users in evaluating overall program costs and performance and in making decisions about resource allocations and changes in programs.

Inter-entity Activities

106. Within the federal government, some reporting entities rely on other federal entities to help them achieve their missions. Often this involves support services, but may include the provision of goods. Sometimes these arrangements may be stipulated by law, but others are established by mutual agreement of the entities involved. Such relationships can be classified into two types depending upon funding methods.

- <u>Provision of goods or services with reimbursement</u>—In this situation, one entity agrees to provide goods or services to another with reimbursement at an agreed-upon price. The reimbursement price may or may not be enough to recover full costs. Usually the agreement is voluntarily established through an inter-agency agreement. Revolving funds can also be included in this group, because they are usually established to recover costs through sale of their outputs to other government entities. They are usually meant to be self-sustaining through their sales, without receiving additional appropriations. However, they do not always charge enough to cover full costs.
- <u>Provision of goods or services without reimbursement</u>—One entity provides goods or services to another entity free of charge. The agreement may be voluntary, legally mandated, or inherently established in the mission of the providing entity.

107. Recently, consideration has been given to expanding the concept of inter-entity support within the federal government. Under this concept, entities could sell their outputs on a competitive basis. Entities would have the authority to purchase goods or services from any federal or private provider. This is seen as a way to improve government efficiency through

competition since inefficient government providers would be forced to improve or stop providing these goods or services. This could result in consolidating support services in fewer governmental entities. Underlying this concept is the requirement that all costs be recognized in developing the price at which goods and services would be sold to other entities.

Accounting And Implementation Guidance[31A]

108. 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.

109. The receiving entity should recognize in its accounting records the full cost of the goods or services it receives as an expense or, if appropriate, as an asset (such as work-in-process inventory). The information on costs of non-reimbursed or under-reimbursed goods or services should be available from the providing entity. However, if such cost information is not provided, or is partially provided, a reasonable estimate may be used by the receiving entity. The estimate should be of the cost of the goods or services received (the estimate may be based on the market value of the goods or services received if an estimate of the cost cannot be made). To the extent that reimbursement is less than full cost, the receiving entity should recognize the difference in its accounting records as a financing source.[32] Inter-entity expenses/assets and financing sources would be eliminated for any consolidated financial statements covering both entities.

Recognition

110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by federal entities. The Office of Management and Budget may

[31A] These paragraphs should be read in conjunction with “Recognition” paragraphs 110 -113 to provide a complete understanding of the implementation of standard on inter-entity costing due to different recognition requirements for certain types of activities.

[32] See Statement of Recommended Federal Accounting Concepts No. 2, *Entity and Display*, par. 65. See also, FASAB Exposure Draft, *Accounting for Liabilities of the Federal Government*, pars. 62-99, pages 26-46, which addresses accounting for pensions and other retirement benefits (ORB). The payment of pension and ORB costs for an entity by another entity has often been likened to providing goods and services. In the case of pensions, employees of the reporting entity provide services to that entity and part of the salary-related cost is paid by a different entity. The pension administering entity does not provide goods or services to the reporting entity (other than normal pension administration services), but rather pays their costs directly. The difference is subtle but important. However, the accounting is similar. This document is consistent with the section of the liabilities exposure draft dealing with accounting for pensions and other retirement benefits.

issue guidance identifying additional inter-entity costs entities should recognize. The inter-entity costs should be specified in accordance with this standard including the recognition criteria presented in paragraphs 111 through 113.

111. Recognition of all significant inter-entity costs is important when those costs constitute inputs to government goods or services provided for a fee or user charge. Generally, the fees and user charges should recover the full costs of those goods and services.[33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold by the federal government. Recognition of inter-entity costs supporting business-type activities[33A] and recognition of inter-entity costs for non-business type activities that elect to do so should be made in accordance with implementation guidance provided by FASAB through one or more Technical Releases.[33B] Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

112. However, the situation is often different with goods or services transferred within the federal government that do not involve eventual sales to entities outside the federal government. The federal government in its entirety is an economic entity. Therefore, it is reasonable to expect some flow of goods or services between reporting entities as those entities assist each other in fulfilling their missions and operating objectives. There are some cases in which the cost of non-reimbursed or under-reimbursed goods or services received from other entities need not be recognized as part of the cost of the receiving entity. The following general criteria are provided to help in determining the types of inter-entity costs that should or should not be recognized.

- Materiality—As with other accounting standards, the provisions of this standard need not be applied to immaterial items. However, in the context of deciding which inter-entity transactions are to be recognized, materiality, as used here, is directed to the individual inter-entity transaction rather than to all inter-entity transactions as a whole. **Under this concept, a much more limited recognition is intended than would be**

[33] OMB Circular A-25 addresses user charges by federal entities.

[33A] Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. (See also SFFAS 6, *Accounting for Property, Plant, and Equipment*, footnote 27.)

[33B] Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs* provides implementation guidance. Additional TRs may be provided by FASAB if needed.

achieved by reference to the general materiality concept.

In this context, then, materiality should be considered in terms of the importance of the inter-entity transaction to the receiving entity. The importance of the transactions, and thereby their recognition, should be judged in light of the following factors:

– Significance to the entity—The cost of the good or service is large enough that management should be aware of the cost when making decisions.
– Directness of relationship to the entity's operations—The good or service provided is an integral part of and necessary to the output produced by the entity.
– Identifiability—The cost of the good or service provided to the entity can be matched to the entity with reasonable precision.

The determination of whether the cost is material requires the exercise of considerable judgment, based on the specific facts and circumstances of each transaction.

- Broad, general support—Some entities provide broad, general support to many, if not all, reporting entities in the federal government. Most often this type of support involves the establishment of policies and/or the provision of general guidance. 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. Thus the standard does not apply when support is of a general nature provided to all or most entities of the federal government.

  An example of this situation can be found in the Office of Management and Budget which establishes policy and provides general guidance to all parts of the executive branch of government. The costs of OMB should not be spread over all reporting entities because the services provided are (1) general and broad in scope, (2) provided to almost all reporting entities in the executive branch, and (3) not specifically or directly tied to the receiving entity's outputs.

  On the other hand, some services provided, under certain circumstances, should still be recognized even though they may be considered broad and general in nature if such services are integral to the operations of the receiving entity. Such services include check writing by the Department of Treasury or legal activities performed by the Department of Justice. For example, when the issuance of checks is integral to the operations of an entity (e.g., the Internal Revenue Service and the Social Security Administration), the receiving entity should include the full cost of issuing checks in the full cost of its outputs. However, if the issuance of checks is insignificant and incidental to the operations of an entity, the entity should not normally recognize that cost.

113. The decision as to whether the cost of non-reimbursed or under-reimbursed goods and services should be recognized requires the use of judgement. None of the criteria listed above are, by themselves, fully or exclusively determinative. They should be considered in combination. Ultimately, inclusion or exclusion of the cost should be decided 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 a reasonable person relying on the information provided.

Component Reporting Entity Disclosures

113A. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full cost. An example disclosure includes:

> Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed [by the component reporting entity] are recognized as imputed cost [in the Statement of Net Cost], and are offset by imputed revenue [in the Statement of Changes in Net Position]. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgment Fund.[33C] However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

Accounting Example

114. The following tables provide an example of the accounting entries to be made when the receiving entity (Agency R) recognizes an expense for services received from a providing entity (Agency P) on a non-reimbursable basis. In the example, the full costs of these services to Agency P are $100,000.

115. Agency R recognizes an “Expense of services provided by Agency P” equal to the full cost of the services received. It also recognizes a financing source, “Services provided by Agency P,” equal to the amount not reimbursed, which in this case is the full $100,000. Agency P recognizes an “Expense of services provided to Agency R” equal to the full cost of the services provided with a credit to “Appropriations used.”

[33C] For simplicity, the illustration addresses only the unreimbursed costs required to be imputed by accounting standards. Component reporting entities should identify the general nature of other imputed costs recognized in their financial statements.

Table 1: Agency R's Accounting Entries*

	Debit	Credit
Expense of services provided by Agency P	$100,000	
Services provided by Agency P		$100,000

Note: This example shows the cost recognized as an expense. However, as discussed in the text, it may be an asset.

Table 2: Agency P's Accounting Entries

	Debit	Credit
Expense of services provided to Agency R	$100,000	
Appropriated capital		$100,000
Fund balance with Treasury	$100,000	
Appropriated capital used		$100,000

Costing Methodology

Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. 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.

The cost assignments should be performed by the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

116. This standard addresses two aspects of costing: cost accumulation and cost assignment. Each of them is explained and discussed below.

Cost Accumulation

117. Cost accumulation is the process of collecting cost data in an organized way. The standard requires that costs be accumulated by responsibility segments. The accumulation is for costs incurred within each responsibility segment, and does not involve the assignment or allocation of costs incurred by other supporting segments, which will be discussed in the latter part of this section.

118. In the section of this document relating to "Responsibility segments," it was explained that: "A responsibility segment is a component of a reporting entity, that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services." The accumulation of costs by responsibility segments does not mean that each responsibility segment must have its own accounting system. The reporting entity may have a centralized accounting system, but the system should be capable of identifying costs with responsibility segments.

119. This standard also requires that the accumulated costs be classified by type of resource, such as costs of employees, materials, capital, utilities, rent, etc. When appropriate and cost effective, information on quantitative units related to various cost categories should be maintained. For example, staff-days may be reported for staff salaries and benefits, and gallons of gasoline consumed for gasoline costs. The quantitative units are useful for cost assignments, and are indispensable for measuring efficiency in using resources.

Cost Assignment

120. The term "cost assignment" refers to the process that identifies accumulated costs with reporting periods and cost objects. The assignment of costs to time periods is to recognize costs either as expenses or assets for each reporting period. It is governed by accounting standards on recognition of assets and expenses, and will not be addressed in this document. This section addresses cost assignment to cost objects. The word "assignment" used in this document includes various methods of attributing costs, such as direct tracing, cause-and-effect basis, and cost allocations.

121. The term "cost object" refers to an activity or item whose cost is to be measured.[34] In a broad sense, a cost object can be an organizational division, program, activity, task, product, service, or customer. However, the purpose of cost accounting by a responsibility segment is to measure the costs of its outputs. Thus, the final cost objects of a responsibility segment are its outputs: the services or products that the segment produces and delivers, the missions or tasks that the segment performs, or the customers or markets that the responsibility segment serves. There may be intermediate cost objects that are used in the course of the cost assignment process.

122. 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

[34]Some literature, the CASB pronouncements for example, use the term "cost objective" for the same meaning.

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.

123. Thus, with respect to each responsibility segment, the costs that are to be assigned to outputs include: (a) direct and indirect costs incurred within the responsibility segment, (b) costs of other responsibility segments that are assigned to the segment, and (c) inter-entity costs recognized by the receiving entity and assigned to the segment. If a responsibility segment produces one kind of output only, costs of resources used to produce the output are assigned to the output.

124. This standard is intended to establish a principle, rather than a methodology, for cost assignment. Also cost assignments may be performed in cost findings and studies or may be performed within a system on a regular basis. In principle, costs should be assigned to outputs in one of the methods listed below 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.

125. These principles apply to all levels of cost assignments including: (1) assigning inter-entity costs to segments, (2) assigning the costs of support services and intermediate products among segments of an entity (the intra-entity cost assignments), and (3) assigning direct and indirect costs to outputs.

Directly tracing costs to outputs

126. Direct tracing applies to resources that are directly used in the production of an output. Examples of such resources include materials that are used in the production, employees who directly worked on the output, facilities and equipment used exclusively in the production of the output, and goods or services received from other entities that are directly used in the production of the output.

127. The method of direct cost tracing usually relies on the observation, counting, and/or recording of the consumption of resource units, such as staff hours or days that are spent on a project or assignment, or gallons of fuel consumed in a transport mission. Direct tracing also applies to specific resources that are dedicated to particular outputs.

128. Direct cost tracing often minimizes distortion and ensures accuracy in cost assignments. However, it can be a relatively costly process. It should be applied only to items that account

for a substantial portion of the cost of an output and only when it is economically feasible. For example, it is usually unnecessary to trace the cost of office supplies (pens, papers, computer disks, etc.) to various activities or outputs. The cost of so doing usually outweighs the benefit of the increased accuracy in assigning the resources.

Assigning costs on a cause-and-effect basis

129. For the costs that are not directly traced to outputs, it is preferable that they be assigned to them on a cause-and-effect basis. As mentioned earlier, the ultimate cost objects of a responsibility segment are its outputs. For costs that are not traced to the ultimate objects (outputs), intermediate objects can be established as links between resource costs and outputs. The links reflect a cause-and-effect relationship between resource costs and outputs. Costs that have a similar cause-and-effect relationship to outputs can be grouped into cost pools. (This similar relationship is referred to in some literature as the "cost pool homogeneity concept.")

130. Activities or work elements that contribute to or support the production of outputs are commonly used as intermediate objects. This is based on the premise that on one hand, outputs require the performance of certain activities, and on the other hand the activities cause costs. Thus, an activity is considered a linkage between the cause and the effect. (See also, discussions on Activity-Based Costing later in this section.) In its policy statement, the Cost Accounting Standards Board expressed a similar view:

> "The preferred presentation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity (input) of the function or functions represented by the pool of cost. This relationship can be measured in circumstances where there is direct and definitive relationship between the function or functions and the benefiting cost objectives."[35]

131. For example, a computer technology department provides technical support to other departments of an organization. The costs of the department may be assigned to other departments on a cause-and-effect basis through two steps. In the first step, the costs are assigned to the activities of the department, such as hardware installation and maintenance, software design and installation, or programming adjustments. In the second step, the costs of these activities are further assigned to other departments based on their consumption of the technical services.

132. Sometimes, an intermediate product, rather than an activity, can be used as a link between the costs and outputs. For example, a hospital laboratory's costs can first be assigned to

[35]Cost Accounting Standards Board, Restatement of Objectives, Policies and Concepts, par. 2915.

various medical tests it runs. The costs of the tests can then be assigned to the operating units of the hospital that ordered the tests.

Allocating costs

133. Sometimes, it might not be economically feasible to directly trace or assign costs on a cause-and-effect basis. These may include general management and support costs, depreciation, rent, maintenance, security, and utilities associated with facilities that are commonly used by various segments.

134. These supporting costs can be allocated to segments and outputs on a prorated basis. The cost allocations may involve two steps. The first step allocates the costs of support services to segments, and the second step allocates those costs to the outputs of each segment. The cost allocations are usually based on a relevant common denominator such as the number of employees, square footage of office space, or the amount of direct costs incurred in segments.

135. Suppose the total cost of a personnel department for a fiscal year is $500,000, and it is allocated to two segments based on the number of employees of the two segments: segment A has 300 employees, and segment B has 200 employees. On the prorated basis, segment A should be allocated 60 percent, or $300,000 of the personnel cost, and segment B should be allocated 40 percent, or $200,000 of the personnel department cost. The allocation is shown below:

Table 3: The Allocation of the Personnel Dept. Costs

Segment	Employees	Percent	Allocated amount
A	300	60	$300,000
B	200	40	$200,000
Total	**500**	**100**	**$500,000**

136. For cost allocation purposes, indirect costs may be grouped into pools, and each pool is subject to one allocation base. Costs grouped into one pool should have similar characteristics. The allocation base should be used consistently to allow cost comparison from one period to another.

137. Cost allocation is a relatively simple method of assigning indirect costs to cost objects. Users of the cost information should be aware that distortions in product costing often result from arbitrary cost allocations. In most cases, there is little correlation between an indirect cost and the allocation base, and the allocation is arbitrary. To assist cost analyses and cost

findings, cost accounting should segregate costs that are traced or assigned to outputs from costs that are allocated to outputs.

Assigning common costs

138. Facility and personnel resources may be shared by two or more activities either at the same time or in different times during a fiscal year. For example, a military aircraft maintained for war readiness may be used in peacetime to transport cargo. As another example, a plant may be used to process two or more products.

139. The cost assignment principles discussed in this section should apply to assigning costs to activities or outputs that share the use of resources. Costs that can be traced to each of the activities (or outputs) should be assigned to them directly. These include direct operating costs of each of the activities. For the military aircraft used in peacetime to transport cargo, for example, the costs of fuel and supplies, additional personnel who worked on the cargo, and other costs incidental to the transportation should be directly assigned to the transportation services.

140. To determine the full cost of each of the activities or outputs that share resources, indirect common costs should be assigned to those activities. The term “common costs” refers to the costs of maintaining and operating facilities and other resources that cannot be directly traced to any one of the activities or outputs that share the resources.[36] Common costs should be assigned to activities either on a cause-and-effect basis, if feasible, or through reasonable allocations.

141. Sometimes management may find it useful to designate primary and secondary activities that share resources. Primary activity is the primary purpose or mission for which the resources are made available. Secondary activities are those activities that are performed only if they will not interfere with the primary activity. Management can then determine two types of costs: (1) the costs that are necessary for the primary activity and are unavoidable even without the secondary activities, and (2) the costs that are caused by the secondary activities and are incremental to the costs of the primary activity. This type of cost information can be produced through cost findings, and may help management in making resource allocation and capacity utilization decisions.

[36]This definition is adapted from Statement No. 1 on Management Accounting: Management Accounting Glossary, published by the National Association of Accountants (Montvale, New Jersey: 1991), page 15.

Cost-benefit considerations

142. Throughout the discussions of this section, it is stated that a cost accumulation and assignment method would be used when it is economically feasible. A method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users.

143. 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 and activities. However, they are preferable because they produce more reliable cost information than cost allocations.

Selecting A Costing Methodology

144. This standard does not require the use of a particular type of costing system or costing methodology. Federal entities are engaged in a broad range of diverse operations. A costing system appropriate for one type of operation may not be appropriate for other operations. At many federal agencies, cost accounting practices are either relatively new or experimental. It is too early to tell which cost systems are best for specific types of operations. As experience and research in cost accounting progress, reporting entities and responsibility segments may find a preferred costing methodology for their operations.

145. Agency and program management is in the best position to select a type of costing system that would meet its needs. In making the selection, management should evaluate alternative costing methods and select those that provide the best results under its operating environment.

146. The standard requires that a costing methodology, once adopted, be used consistently. Consistent use provides cost information that can be compared from year to year. However, this requirement does not preclude necessary improvements and refinements to the system or methodology, so long as the effect of any change is documented and explained. On the contrary, improvements are encouraged.

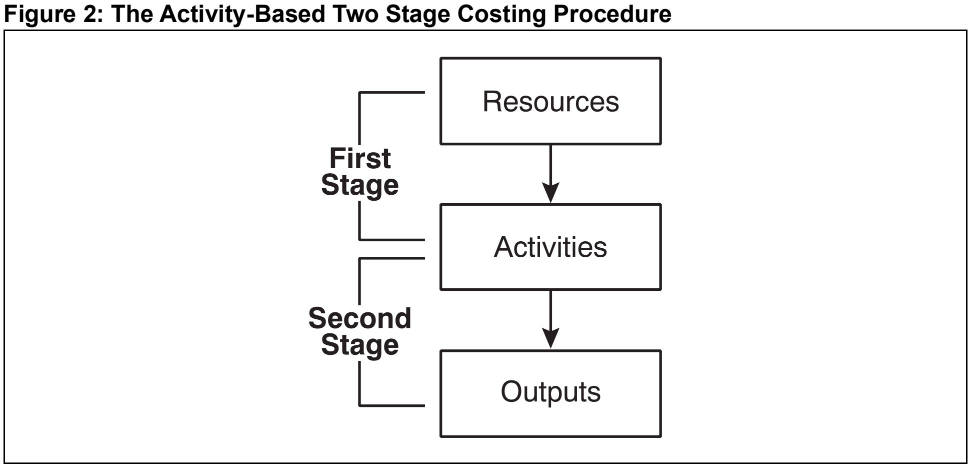
147. Several costing methodologies have been successful in the private sector and in some government entities. Four are briefly described below for agency consideration. It should be noted in particular that activity-based costing has gained broad acceptance by manufacturing and service industries as an effective managerial tool. Federal entities are encouraged to study its potential within their own operations. In the following paragraphs, activity-based costing will be introduced with other well known costing methodologies, namely job order costing and process costing. Standard costing is also mentioned as an important cost management tool. It is important to note that those costing methodologies are

not mutually exclusive. Both activity-based costing and standard costing can be applied to job order or process costing systems.

Activity-based costing (ABC)

148. ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs. The procedure is illustrated in the following figure.[37]

Figure 2: The Activity-Based Two Stage Costing Procedure



149. Implementing an ABC system requires four major steps: (1) identify activities performed in a responsibility segment to produce outputs, (2) assign or map resources to the activities, (3) identify outputs for which the activities are performed, and (4) assign activity costs to the outputs. Each of the steps is briefly explained below.

(1) Identify activities. This step requires an in-depth analysis of the operating processes of each responsibility segment. Each process may consist of one or more activities required by outputs. Activities may be classified into unit-level, batch-level, product

[37]The figure and the accompanying discussions are based on Robin Cooper, Robert S. Kaplan, Lawrence S. Maisel, Eileen Morrissey, and Ronald M. Oehm, Implementing Activity-Based Cost Management (Montvale, NJ: Institute of Management Accountants, 1992), pages 9-13.

sustaining, and facility sustaining activities.[38] Management may combine related small activities into larger activities to avoid excessive costing efforts.

(2) Assign resource costs to activities. This step assigns resource costs to the activities identified in step 1. The resource costs include direct and indirect costs usually recorded in general ledger accounts. Depending on feasibility and cost-benefit considerations, resource costs may be assigned to activities in three ways: (a) direct tracing; (b) estimation based on surveys, interviews, or statistical sampling; or (c) allocations.

(3) Identify outputs. This step identifies all of the outputs for which activities are performed and resources are consumed by a responsibility segment. The outputs can be products, services, or customers (persons or entities to whom a federal agency is required to provide goods or services). Omitting any output would result in overcharging costs to other outputs.

(4) Assign activity costs to outputs. In this step, activity costs are assigned to outputs using activity drivers. Activity drivers assign activity costs to outputs based on individual outputs' consumption or demand for activities. For example, a driver may be the number of times an activity is performed in producing a specific type of output (the transaction driver), or the length of time an activity is performed (the duration driver).

150. ABC can be used in conjunction with job order costing or process costing. For example, making direct loans to the public involves a series of processes, such as loan origination, credit review for individual applicants, preparing loan documents, valuation of collateral, making loan disbursements, computing fees and periodic payments, keeping records, and making collections. These are the "first category" activities that directly affect individual loans. ABC can be applied to this category of activities.

151. The direct loan operations also involve "second category" activities, such as those performed by loan officers to review and assess a portfolio of loans and make policy changes that affect an entire portfolio. If ABC is not used, the costs of the loan officers may be allocated to direct loans based on the number of loans disbursed, or based on the staff hours spent on processing all the loans. However, such an allocation tends to be arbitrary, because some loans require more of their time than others. Under ABC, the costs of loan officers would first be assigned to their portfolio review and workout activities that they perform, then the activity costs would be assigned to the groups of loans for which the activities are performed.

[38] Cooper, Kaplan, et al. page 20.

152. A major advantage of using ABC is that it avoids or minimizes distortions in product costing that result from arbitrary allocations of indirect costs. By tracing costs through activities, ABC provides more accurate service or product costs. Experience in the private sector shows that by providing accurate cost measures, ABC has helped improve product costing, strategic pricing, and profit planning.

153. Also important is that ABC encourages management to evaluate the efficiency and cost-effectiveness of activities. Some ABC systems rank activities by the degree to which they add value to the organization or its outputs. Managers use such value rankings to focus their cost reduction programs. ABC encourages management to identify and examine (a) what activities are really needed (value-added activities) in order to accomplish a mission, deliver a service, or meet customer demand, (b) how activities can be modified to achieve cost savings or product improvements, and (c) what activities do not actually add value to services or products (non-value-added activities). ABC integrates with cycle time analysis and value-added analysis.

Job order costing

154. Job order costing is a costing methodology that accumulates and assigns costs to discrete jobs. The word "jobs" refers to products, projects, assignments, or a group of similar outputs.

155. Each job has a number or code to accumulate costs. Resources spent are identified with the job code. Costs are traced to individual jobs to the extent economically feasible. Costs that cannot be directly traced are assigned to jobs either on a cause-and-effect basis or allocation basis.

156. Job order costing is appropriate for responsibility segments that produce special order products, or perform projects and assignments that differ in duration, complexity, or input requirements. Typical situations in the federal government in which job order costing would be appropriate are legal cases, audit assignments, research projects, and repair work for ships, aircraft, or vehicles.

Process costing

157. Process costing is a method that accumulates costs by individual processing divisions (organization divisions that perform production processes). These processing divisions are involved in a continuous production flow, with each division contributing towards the completion of the end products. The output of a processing division either becomes the input of the next processing division or becomes a part of the end product.

158. Each division accumulates costs, assigns the costs to its outputs, and calculates the unit cost of its output. For each period, divisions prepare a cost and production report, showing

the costs, the completed units, and the work-in-process volume. When a certain number of completed units are transferred from a division to the next division, the costs of those units are also transferred and are eventually incorporated into the costs of the end product. Thus, the cost flow follows the physical flow of the production. The unit cost of the end product is the sum of the unit costs of all the divisions.

159. Process costing is appropriate for production of goods or services with the following characteristics: (a) the production involves a regular pattern of process, (b) its output consists of homogeneous units, and (c) all units are produced through the same process procedures. In the private sector, process costing is used by such industries as flour mills, steel foundries, oil refineries, and chemical processing plants. In government, it may be used by some activities that involve repetitive process procedures to deliver a large volume of similar goods or services. An example would be making entitlement benefit payments, which involves a series of consecutive processes for reviewing applications to establish their eligibility, computing the amount of benefits, and issuing checks.

Standard costing

160. Standard costs are carefully predetermined or expected costs that can be applied to activities, services, or products on a per unit basis. Horngren describes standard costing as follows:

> "A set of standards outlines how a task should be accomplished in nonfinancial terms (minutes, board feet) and how much it should cost. As work is being done, actual costs incurred are compared with standard costs for various tasks or activities to reveal variances. This feedback helps discover better ways of adhering to standards, of altering standards, and of accomplishing objectives."[39]

161. Many organizations frequently review and update the standards to assure that they encourage improvements in efficiency and are within an attainable range.

162. Standard costing helps managers to formulate budgets, control costs, and measure performance. It can be used in conjunction with job order costing, process costing, and activity-based costing. It can be applied to specific outputs or activities, and it can also be applied to a responsibility segment in aggregate by comparing total actual costs with total standard costs based on outputs produced within a certain time period. Typical situations in the federal government in which standard costing would be appropriate are operations that produce services or products on a consistently repetitive basis. Agencies are encouraged to use standard costing in those situations.

[39] Horngren, Charles T. and George Foster, Cost Accounting, A Managerial Emphasis, 7th ed. (Prentice Hall, Englewood Cliffs: New Jersey, 1991), page 222.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

The Nature of Concepts and Standards

163. The difference between accounting concepts and standards is significant. Statements of concepts are more general than statements of standards. Standards are intended to be specific guidance and authoritative in nature. Concepts generally do not contain specific recommendations that would, when issued by the Board's sponsors, become authoritative requirements for federal agencies. Concepts, instead, provide general guidance both to the Board and others. They are also intended to help preparers and users of financial information better understand federal accounting and financial reporting. While the differences can be easily stated, in reality the line between concepts and standards is often broad and presents many gray areas for interpretation.

164. When the Board began the project on managerial cost accounting, it anticipated the issuance of a recommended Statement of Concepts. Given the meager use of cost accounting within many federal agencies, a Statement of Concepts would provide both the Board and preparers of federal financial reports with overall guidance in the area and an indication of the future direction the Board might take in developing standards. However, as the Board and staff began working on the project, it became clear that action was needed to recommend standards for the development of cost information.

165. Cost accounting standards were needed because users of financial information, especially taxpayers and members of Congress, began putting more emphasis on the cost of government programs, products, and activities. The efforts to reduce government spending, control the deficit, and improve government functions necessitated information about the true costs of government. In addition, passage of the CFO Act and the GPRA required agencies to provide cost information as a part of improving their financial management and reporting. Furthermore, the NPR issued a recommendation that the Board move rapidly to recommend cost accounting standards.

166. The Board established the Cost Accounting Task Force to provide advise and guidance on the cost accounting project. On the task force were many individuals knowledgeable about

cost accounting in the private sector as well as the limited federal cost accounting activities. The task force also recommended the establishment of cost accounting standards.

167. The Board issued the exposure draft as a recommended statement of standards. The Board knew, however, that since cost accounting is relatively new in the federal environment, the final statement necessarily would contain some conceptual material. Although the exposure draft did not present any direct questions concerning whether parts of the draft should be viewed as concepts, the issue did arise in public hearings held in November 1994, and January 1995. In addition, a few respondents who mailed in their comments addressed the point.

168. Most of those commenting on the issue stated that they viewed the exposure draft as being somewhat conceptual in nature. Many of those thought that this was appropriate and supported the document and the conceptual material it presented. A few respondents were concerned about the ability to audit some of the standards because of the conceptual nature of the document. Several suggested that the final statement be segregated into concepts and standards and both be issued in one statement.

169. The Board decided that some parts of the final statement would contain information that should be presented as concepts while other parts would be better presented as standards. Therefore, the final statement should be a “hybrid” issuance containing both concepts and standards. The title of the document was changed to “Managerial Cost Accounting Concepts and Standards for the Federal Government.” (The Board decided that the material presented in the exposure draft as the first standard that addressed the relationship among managerial cost accounting, financial reporting, and budgeting should be presented as concepts. The other materials were more in the nature of standards.)

Relationship Among Cost Accounting, Financial Reporting, And Budgeting

170. The Board considers it important for financial preparers and users of financial reports to understand the relationship of cost accounting to the more traditional areas of general financial accounting, financial reporting, and budgeting. It views cost accounting as a basic and integral part of an entity’s financial management system. Therefore, the Board included a standard on this relationship within the exposure draft.

171. The standard addressed the role of managerial cost accounting in financial management and explained how it provides cost information relevant to budgeting, financial reporting, management control, and many decision making processes. The standard discussed the use of a common data source for cost accounting, financial accounting, and budgeting. It explained how the costs may be determined using different bases of accounting and different recognition and measurement methods depending upon the intended use of the

information. It also emphasized the need for reconciliation of cost data which may be presented differently in various financial reports. The standard stated that all cost information, regardless of how presented, should be traceable back to the original common data source.

172. Most exposure draft respondents who provided comments on this standard stated that the level of detail presented was about right given the desire of the Board to address cost accounting at a high level. Most respondents agreed with the need to draw cost accounting data from a common data source that is also the source of financial and budgetary data. Some respondents were concerned that the use of the term “data source” was too closely allied with automated or computerized operations and that the term may be misinterpreted. The Board, however, believes that the term is adequately explained. In fact, the exposure draft clearly stated that this term was not meant to imply the use of computerized systems for source information.

173. Data reconciliation for reports containing cost information developed on different bases of accounting or using different recognition or measurement methods received overwhelming support from respondents to the exposure draft. They said that the ability to reconcile differing cost information is necessary to ensure data integrity, avoid confusion on the part of financial statement users, and support stewardship responsibilities.

174. Many who commented on whether the exposure draft should be viewed as a statement of concepts or a statement of standards implied that this particular standard on relationships of cost accounting to other financial management functions was basically conceptual in nature. The Board agreed and concluded that this section is more in the nature of an explanation of how cost accounting provides useful information and how it fits in with the overall financial management system as opposed to a standard which places a requirement on an entity. The Board decided that this material would be better presented in the final statement as recommended concepts.

Requirement For Cost Accounting

175. The cost accounting task force recommended that a standard be included in the exposure draft requiring each reporting entity to establish cost accounting systems and procedures for its activities. They believed this was necessary to ensure the generation of required cost information.

176. The Board agreed to include the standard in the exposure draft. The standard defined “system” in a broad way as simply an organized grouping of methods and activities designed to consistently produce reliable cost information. The explanations and discussions section of the exposure draft contained information on several factors that

would help managers decide how complex and sophisticated their cost accounting system should be. It noted that the system could be constrained by the (1) nature of the entity's operations, (2) precision needed in cost information, (3) practicality of data collection and processing, (4) availability of electronic data handling, (5) expected cost of the system itself, and (6) any specific management information needs.

177. The exposure draft also listed ten minimum criteria that should be met by all managerial cost accounting systems. Four of these were related directly to the other standards in the exposure draft (responsibility segments, full costing, costing methodology, and unused capacity costs). The six remaining criteria were concerned with ensuring that the cost data produced was reliable, consistent, and useful. These criteria were (1) ensuring the ability to assist in measurement of performance, (2) reporting information on a timely and consistent basis, (3) integrating cost accounting with the standard general ledger, (4) determining a reasonable and useful level of data precision, (5) accommodating special information needs of management, and (6) documenting the system through a manual or handbook. The standard also allowed for the use of cost finding techniques and special cost studies or analyses.

178. A large number of respondents to the exposure draft supported the requirement for cost accounting systems. They stated that such a requirement is necessary to ensure that appropriate cost data are recorded. They also said that having a requirement for cost systems will help agencies to more easily meet the requirements of the CFO Act and the GPRA. Some qualified their support by stating that the standard should allow an exemption for small entities since establishment of a full cost accounting system may not be cost-beneficial to them. The Board decided that such an exemption would be inappropriate since the standards should apply to all federal activities. Furthermore, it should be far easier for small entities to perform managerial cost accounting in most cases.

179. Those who were negative toward the standard provided several reasons. Several expressed concern about whether accounting standard-setting bodies should require or determine how accounting data are produced. They noted that other accounting standard-setting organizations have stated only what information is required and how that information is displayed in financial statements, not how the information is developed.

180. The Board believes that it should not be constrained by what other standard-setters do. Other standard-setters so far have concerned themselves mainly with entities' external reporting. This is understandable because their mission is to assure that the financial position and results of operations are presented in a fair, reliable, and consistent manner to financial statement users who are external to the reporting entity.

181. FASAB is different in that it has determined that some of the users of federal government financial reports are internal to the government. Given the nature and size of the federal

government, internal users often do not have the same type of access to cost information that may be available in commercial enterprises. In addition, the Board views cost accounting information as vital to both internal and external users. The Board has previously determined in its *Objectives of Financial Reporting* that cost information should be reported to meet the needs of Congress, federal executives, and others.

182. Some respondents to the exposure draft were concerned that the requirement for a cost accounting system, along with the system criteria, would not allow management enough flexibility. They seemed to consider the requirement for a system to mean that cost accounting activities had to be automated with computers and that software had to be developed and employed in a “full-blown” system, as one put it. They believe that such an elaborate system may not be needed in some cases where informal procedures or methods would suffice.

183. The Board does not intend to prescribe an elaborate managerial cost accounting system for every federal organization. It believed that the standard proposed in the ED was sufficiently broad to allow managerial flexibility in the system design. However, the Board does recognize that the term “system” may connotate to some a requirement for computerization and sophisticated methodologies.

184. Others stated that establishing the requirement for cost systems should be the responsibility of OMB or JFMIP. Some of the respondents were concerned about the degree to which the standard may overlap with JFMIP’s responsibility to set requirements for cost accounting systems. The NPR recommends setting requirements for cost accounting systems as a responsibility of JFMIP, while asking the Board to provide the cost accounting standards.[40]

185. The Board proposed the requirement for systems to ensure that cost information is produced and reported in a reliable and consistent manner, and emphasized that this was the intent. The point is not whether the information is produced through the use of a system or through other techniques. The Board believes that, in many cases, cost accounting systems will be established as a natural consequence of requiring cost information. Many government agencies are very large and complex organizations, and it is unrealistic to think that they can develop cost data without relying on a system to do so. Other small agencies or reporting entities may not need a system to develop cost data in a regular, consistent, and reliable manner.

186. The Board, therefore, changed the standard to emphasize producing cost accounting information in a reliable and consistent manner. This can be done through the use of cost

[40]Office of the Vice President, Improving Financial Management, Accompanying Report of the National Performance Review (September 1993), page 24.

accounting systems or cost finding techniques. In either case, the main intent of the original standard is preserved. In addition, the concerns expressed over whether the Board or some other organization should establish the requirement for cost “systems” are solved.

Responsibility Segments

187. As stated in the ED, a responsibility segment is a component of a reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services.

188. The proposal for using responsibility segments in the ED was based on the view that most federal departments and agencies are engaged in more than one line of activity, or producing more than one type of service or product. Furthermore, the activities that an agency performs may differ from each other significantly in required resources and operations. The ED used the Department of Veterans Affairs (VA) as an example. Among its activities, VA administers hospitals and nursing homes to provide health care to veterans, and it also administers direct home loan and loan guarantee programs. These lines of activities are significantly different in operation patterns. The Board believes that for entities that are engaged in diverse activities, identifying responsibility segments is necessary for identifying resources consumed by a distinct line of activity with the outputs of that activity.

189. A majority of respondents supported the requirement for responsibility segments and agreed with the advantages of the requirement. They expressed the view that segmentation provides a basic framework to trace and assign costs to outputs. They also believed that segmentation provides management with the flexibility of choosing a costing methodology that is best suited for a line of activity. The respondents also stated that information generated by responsibility segments can be used to measure performance and to assess accountability.

190. Several respondents, however, presented arguments against using responsibility segments. One such argument was that responsibility segments would constitute an unnecessary layer that conflicts with financial reporting and budgeting systems. The Board disagrees with this view. A responsibility segment is not, and should not be, an additional layer to the organization and the budget structure. It is an accounting mechanism to capture data generated in operations by various components of an organization in its existing structure. Organization and budget structures can be changed for better management but not for the sake of accounting. Accounting may influence but cannot dictate such changes.

191. The Board believes that accounting by segment will help provide information useful to program managers and other users of financial reports. Entity-wide financial reports provide information on the overall financial position and operating results of an entity in aggregate.

Such reports, although useful for many purposes, are not sufficient for cost management. A fundamental undertaking of managerial cost accounting is to match costs with activities and outputs. The purpose of segmentation is to segregate entity-wide data by major lines of activities and their outputs. Information related to each segment should tell managers and other users of financial reports about the segment's specific outputs, the activities performed, and resources consumed to produce the outputs.

192. Furthermore, segment-based reporting need not be in conflict with entity-wide financial reporting. They can use a common source of data, such as accounting data collected by the standard general ledger or the budget execution reports. To perform segment-based accounting and reporting, the general accounting or budget execution data can be traced and assigned to segments. The Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, discusses a reporting approach similar to the segment-based accounting and reporting:

> "With some organizations, and even suborganizations, the activities of one or more programs or other components are as important to the readers of financial statements as are activities of the entity as a whole. This would be particularly true for a department composed of many bureaus, administrations, agencies, services, etc., and particularly if their programs are dissimilar. In those instances, consideration should be given to the preferability of reporting the assets, liabilities, revenues, expenses, etc., of both the significant components individually and of the entity in its entirety."[41]

193. Another argument against requiring responsibility segments was that the requirement is overly prescriptive and would constrain agency management from selecting among various cost collection methods. The Board believes the standard gives management adequate flexibility in structuring cost accounting. As the standard states, it is for the management of each entity to decide how segments should be defined, and how similar products and services can be grouped into one segment.

194. Furthermore, segments are the largest components of an entity. Management has the flexibility to use any cost collection method within each segment. Within a segment, management may define sub-units, functions, projects, business processes, activities, or a combination of them as cost centers to accumulate costs. The costs accumulated at lower levels can then be aggregated to the segment level.

195. In fact, a segment may contain multiple levels of responsibility or cost centers. For example, if veterans health care is defined as one of the DVA's responsibility segments, this segment may define its hospitals, clinics, and nursing homes as responsibility centers. Each hospital, clinic, and nursing home may further define their functional units, activities, or business processes as cost centers.

[41] FASAB Statement of Recommended Accounting Concepts 2, *Entity and Display*, par. 75.

196. Some respondents correctly pointed out that requiring broad responsibility segments, rather than prescribing traditional cost centers, provides opportunity for entities to use activity-based costing or any other costing methods that they may find appropriate.

197. Several respondents who supported the use of responsibility segments interpreted the wording of the proposed standard as requiring that each segment perform managerial cost accounting. They pointed out that for some entities, it is more effective and economical to perform centralized managerial cost accounting. Such centralized accounting is capable of accumulating costs by segments and assigning costs among them. The respondents requested that the wording be revised to provide this flexibility.

198. The Board agrees with this request. The Board believes that entity management should have the discretion to decide whether managerial cost accounting is performed at the entity or segment level, so long as the segment cost information is provided to managers and other users. Thus, the standard recommended in this statement does not require that responsibility segments perform managerial cost accounting.

Full Cost

199. As stated in the ED, the full cost of an output produced by a responsibility segment is the sum of direct and indirect costs that contribute to the output, including the costs of supporting services provided by other segments and entities.

200. The outputs of a responsibility segment are considered as cost objects.[42] However, in most circumstances, the full costs of intermediate objects, such as activities, processes, projects, programs, or organization units, must also be measured in order to derive the full costs of their outputs. (See ED Par. 173) The full cost information related to outputs as well as those intermediate objects are useful in measuring efficiency and cost-effectiveness.

Usefulness of full cost information

201. **Program evaluation and authorization.** Most respondents supported the full cost standard. They recognized that it is particularly important to determine and report the full cost of a program. Information on full costs of programs can be used in program evaluations. Such evaluations typically relate the full costs of programs to their outputs and outcomes. Decision-makers in the Congress and the federal government at all levels as well

[42]"Cost object" is defined as 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. See Glossary.

as the public should be provided with information on the full costs of programs and their outputs. The full cost information, when used with information on program outputs and outcomes, can aid the Congress and federal executives in making decisions on program authorization and modifications.

202. **Cost awareness.** Most respondents also agreed that the standard has the advantage of promoting cost awareness. Entity and segment managers should be aware of the costs that are incurred or assigned to their operations. Without the awareness, managing and controlling costs are impossible. The full cost information has not been available and will not likely to be without an accounting standard requiring it.

203. **Setting fees and prices for government goods and services.** Many respondents agreed that full cost should be considered as a primary basis for setting fees and reimbursements for government goods and services. As pointed out in the ED, it is a federal policy that, with certain exceptions, user charges (prices or fees) should be sufficient to recover the full cost of goods, services, and resources provided by the federal government as sovereign.[43] The policy further states that when the government sells goods and services under business-like conditions rather than in a sovereign capacity, user charges should be based on market prices and may yield a net revenue in excess of the full cost. The objectives of the policy are to: (1) ensure that government goods and services are provided on a self-sustaining basis, (2) promote efficient allocation of national resources, and (3) allow fair competition with comparable goods and services provided by the private sector.

204. To implement the policy, full cost information is necessary. Only with reliable full cost information can management ensure that user charges fully recover the costs.[44] Even in some exceptional cases in which user charges are exempted or restricted by law, agencies that provide the goods and services would nevertheless need the full cost information to assess the extent to which costs are not recovered.

205. **Making cost comparisons.** Respondents agreed that the full cost of outputs provides a valid basis for cost comparisons. One of them emphasized the importance of calculating the unit cost of output on the full cost basis. The Board agrees with his view. If an output can be measured in units, its unit cost should be calculated on the full cost basis.

[43]OMB Circular No. A-25, User Charges.

[44]The standard of determining full cost discussed in this document, however, should not be construed as a standard for setting fees, prices, and reimbursements. Federal entities should comply with laws and regulations related to pricing policies in general and for specific types of goods and services. Those laws and regulations (including OMB Circular A-25) may prescribe costing requirements other than the full cost standard discussed in this document. Full cost defined by this standard can serve as a point of reference for managerial decisions. However, it is not intended to supersede any costing concept that management is required or permitted by law to use in pricing goods and services.

206. The unit cost of a service or product, calculated on a full cost basis, can be compared with a similar service or product produced by other entities either in the federal government or in the private sector. The comparison would not be valid if it is not conducted on a full cost basis.

207. One of the available cost management tools is trend analysis. In trend analysis, unit costs of a service or product over a number of consecutive periods are examined to find a trend of increases or decreases. This analysis can be valid only when the unit costs of all periods are measured on a consistent basis, such as the full cost basis. When the full cost basis is used, the analyst can further examine the components of the unit cost, such as direct labor and material costs, overhead costs, and costs of services received from other segments or entities. Through examining the various components of the full unit cost, program managers can pinpoint specific areas that contributed to cost increases or decreases.

208. If activity-based costing is used, the cost components would be associated with activities. The trend analysis for activity-based cost components can provide information related to the efficiency of the activities. Managers can also analyze the extent that the individual activities add value to program outputs and objectives.

Limitations of Full Cost Information

209. Several respondents cautioned the Board against “uncritical advocacy” of full costs. They pointed out that full cost is not relevant to all decision-making situations. They explained that some decisions require other cost concepts such as variable, differential, or incremental costs. Thus, some of them said that the Board should not singularly emphasize full cost.

210. The Board is aware of the notion that different cost concepts should be used for different purposes so that the use of a cost concept is relevant to a particular decision-making purpose. For this reason, the Board discussed the limitations and usefulness of full cost in the ED at length. (See ED pars 133 through 146.) Quoting from Anthony and Young, the ED pointed out that full costs are not appropriate for alternative choice decisions such as the decision to (1) add or drop a product or service, (2) perform work in-house or contract out for it, and (3) accept or reject a special request. For these decisions, the appropriate information is differential costs.[45]

211. However, the full cost standard is an accounting standard, rather than a cost analysis or decision-making standard. It requires that full cost information be compiled and reported through cost accounting. In no way does it limit cost analysts and decision-makers to the

[45]Robert N. Anthony and David W. Young, Management Control in Nonprofit Organizations, 5th ed. (Burr Ridge, Illinois: Richard D. Irwin Co., 1994) page 235.

use of full cost alone in all situations. The Board believes that when the full cost information, instead of any portion of it, is made available, analysts and decision-makers will have a comprehensive data source to develop the cost concepts that they need in their analyses.

212. Some respondents pointed out that full cost requires a complex process of cost assignments and allocations. The Board believes that the assignment of indirect costs is a necessary procedure to obtain full cost. It can be performed through an appropriate costing methodology. As discussed in the costing methodology section of the ED, some modern costing methodologies are available to make rational and reliable cost assignments. However, the Board must caution that the full cost information, like any other accounting information, can only be as good as how it is prepared. For example, it can be unreliable or inaccurate, if arbitrary or irrational cost allocations are used excessively. Thus, the Board recommended a costing methodology standard. Program managers should critically review costing methodologies and techniques used to derive the cost information.

Inclusion or Exclusion of Certain Costs

213. A number of respondents were opposed to the inclusion of accrued employee benefit costs and costs of services provided by other entities that are not reimbursed. (The subject of inter-entity costs will be discussed in the next section.) They argued that these costs are not funded with their budgetary resources and are beyond their control. A large portion of employee benefit costs, including accrued retirement benefit costs, are funded through appropriations to trust funds managed by OPM and DoD. The Board believes that as a principle, full cost should include the costs of all resources applied to a program, activity, and its outputs, regardless of funding sources. For financial reporting, the Board has stated its position that the full costs of employee pension and other retirement benefits determined on an actuarial basis, including the amounts that are funded to the trust funds directly, should be recognized as an expense in the employer entity's financial reports.[46] The Board does not find a good rationale to depart from this principle in managerial costing.

214. The ED states that some costs should be recognized as a period expense rather than the costs of goods and services (output costs). Examples include the costs of "other post employment benefits" (OPEB), reorganization costs, and acquisition costs of Federal "mission" and "heritage" property, plant, and equipment which are recognized as expenses at the time of acquisition.[47] These costs will be recognized as expenses for the period in which the related events take place, and are referred to as "period expenses." The ED

[46]FASAB Exposure Draft, Accounting for Liabilities of the Federal Government (Nov. 1994), pars. 80-99, pages 32-46.

[47]"Federal mission PP&E" and "heritage assets" are explained in FASAB Exposure Draft, Accounting for Property, Plant, and Equipment (February 28, 1995), pars. 98-115, pages 29-33.

explained that since these expenses do not contribute to the outputs of the period in which they are incurred, they should not be included in the output costs.

215. The OPEB costs, for example, may be recognized as expenses for a period in which a reduction in force or an employee injury takes place.[48] It is not appropriate to attribute the entire OPEB costs to the output costs of that period. Several respondents expressed the view that OPEB costs should be included in full cost. There is no doubt that OPEB costs, as well as other period expenses, are part of the full cost of an entity or a program. They may also be part of the full costs of outputs over many years in which the employees contributed to the production of the outputs. However, they are not the production costs for the period during which they are incurred. Thus, the Board concluded that in cost studies, management may distribute some of the period expenses, such as OPEB costs, to outputs over a number of past periods if (a) experience shows that the OPEB costs are recurring in a regular pattern , and (b) a nexus can be established between the OPEB costs and the outputs produced in those past periods. The Board finds no reason to change this position.

216. Some respondents contended that full cost should include unused capacity costs. As will be explained in a later section on unused capacity costs, the Board has decided not to recommend a standard on measuring unused capacity costs. Thus, to assure valid cost comparisons, full costs should <u>not</u> exclude unused capacity costs.

Controllable and Uncontrollable Costs

217. Some respondents believed that the managers of a responsibility segment should be held accountable only for costs that they can control, and their performance should not be evaluated for costs beyond their control. They found that the full cost reporting would obscure the distinction between controllable and uncontrollable costs. For performance measurement or other purposes, some entities may want to make a distinction between controllable and uncontrollable costs with respect to an individual responsibility segment or a cost center. The full cost information need not interfere with this distinction. This standard does not require the use of full cost for internal reports. If some entities choose full cost for internal reporting, the internal reports can provide a distinction between controllable and uncontrollable costs with respect to individual segments.

218. Ultimately, most costs are controllable at a certain level of the entity. If some of them are not controllable at a lower level of the organization, they may very well be controllable at a higher level. Each segment should concern itself with the costs that are assigned to it on a cause-and-effect basis. These costs are often incurred because of a segment’s demand and

[48]FASAB Exposure Draft, Accounting for Liabilities of the Federal Government (Nov. 7, 1994), pars. 100-102, pages 47-48.

use of services from other segments or entities. Although the service-receiving segment has no control over the efficiency in producing the service, it can influence the costs by changing the demand for the service. For an entity's top management, full cost reporting provides it with an overview of how the entity's various costs, including the general and administrative costs, are incurred and assigned to the entity's segments. The full cost reporting also makes the entity's top management aware of the costs of services that it receives from other entities. The management can closely review those costs and determine whether actions are needed to control them.

Centralized Accounting

219. The proposed standard in the ED states that "Responsibility segments should be capable of measuring the full costs of their outputs." Several respondents stated that the full costs of segments, programs, and their outputs can be more effectively measured by entities through centralized accounting, rather than by individual segments. They further stated that it would not be cost-beneficial for segments to measure and report the full costs of their activities and outputs on a regular basis (such as monthly basis). The Board agrees that many entities may find it more economical and effective to measure full costs through centralized accounting. Moreover, the Board believes that it should be for entity management to decide as to how frequently the full cost information should be made available in its internal reports. Thus, the wording of the standard has been changed. The full cost requirement is now limited to external reporting via general purpose financial reports.

Costs of Outcomes

220. A respondent suggested that in addition to the full cost of outputs, the standard should also require reporting the full cost of program outcomes. As discussed in the ED, the Board believes that performance measurement of a program requires three major elements: the full cost of the program, its outputs, and its outcomes. (See ED pars 37 and 38) The full cost of a program and its outputs, once measured according to this standard can be related to the outcome of the program to measure its cost effectiveness.

221. This standard does not require a direct measurement of the cost of outcomes because in most instances, program outcomes need to be measured with methodologies beyond those discussed in this document. GPRA defined "outcome measure" as an "assessment of the results of a program activity compared to its intended purpose."[49] Many programs' policy objectives and intended results are socio-economic or scientific in nature, or involve national

[49]The Government Performance and Results Act of 1993, PL 103-62, sec 4.

defense. The assessment of the program results require expert knowledge in those areas. Thus, unlike costs and outputs, outcomes are not always measured in quantitative or monetary terms.

222. Moreover, unlike costs and outputs that are measured for each accounting and reporting period, such as a quarter or a year, outcome measurement may be long-term in nature. For example, the Senate Report on GPRA states that “Outcome measurement cannot be done until a program or project reaches a point of maturity (usually at least several years of full operation for programs continuing indefinitely) or at completion.” Although all programs cost money, some of them may produce positive results, while others may produce no results or negative results.

223. Because of the complexities in measuring outcomes, the costing principles and methodologies discussed in this document cannot be used to measure the cost of outcomes. The Board believes that the full cost of a program and its outcome should be measured independently, using methodologies appropriate to costs and to outcomes. Once each of them is measured, they can then be related to review the cost-effectiveness of the program.

Inter-entity Costs

224. It is not unusual in the federal government for one agency to provide goods or services to another agency. Sometimes this may be required by law, and often it is a very efficient method of conducting business for the agencies involved and for the government as a whole. In many cases, the agency receiving such goods or services will reimburse the providing agency in accordance with some agreed-upon price. Often, however, there is no charge, or there is a charge that is not sufficient to cover the providing agency’s full cost. When such “free” or lower-than-cost items are used in the production of the receiving agency’s outputs, the result can be an understatement of the full cost of final outputs by the receiving agency.

Survey of Non-Reimbursed Costs

225. The Board recognized that these non-reimbursed or under-reimbursed goods and services could distort the determination of a reporting entity’s full cost of outputs, but it was uncertain of the extent to which this occurs. To identify examples of non-reimbursed inter-entity costs, the Board conducted a limited survey of federal agencies. Of the 22 agencies responding to the survey request, 13 indicated that they provide some type of service or good that is not reimbursed. These covered a wide range of activities, but most of the costs involved were for salaries and salary-related benefits of those employees performing the work. In most cases, the costs were funded through direct appropriations to the providing agencies;

however, those agencies could not specifically identify the total amounts involved. Several provided estimates, which ranged from $360 thousand dollars per year to about $180 million per year. Several examples of non-reimbursed inter-entity activities identified in the survey are listed below by providing entity:

- Department of Agriculture -- Provides market data, pesticide data, food specification information, water supply forecasts, and other agricultural information. Thirty-six federal agencies regularly receive all or some of this information.

- Department of Commerce -- Provides accounting and grant administration services, computer access and reports, and consultation services to several agencies.

- Department of State -- Provides space and facilities for other agencies in its buildings in the U.S. and overseas.

- General Services Administration -- In some cases, it provides policy and regulatory development services, property management services, and contract award and administration to other agencies without reimbursement.

- National Science Foundation -- Administers a research grant program on engineering and computer science for the Department of Defense.

226. The Board noted that the survey was restricted to non-reimbursed costs between different agencies. As such, the results did not necessarily represent all of the kinds and amounts of transactions and costs between different reporting entities. The survey was also limited to those non-reimbursed costs which the agencies could easily identify in order to respond quickly to the questionnaire. Nevertheless, there were indications that some non-reimbursed costs may be significant in amount.

Usefulness of Recognition

227. Some respondents to the exposure draft stated that recognition of inter-entity[50] costs would have limited usefulness for managers since they cannot control the cost of items provided by other agencies. In some circumstances, they cannot control the amounts of inter-entity goods or services that must be used in the production of their outputs.

[50] 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.

228. The Board realizes that recognition of non-reimbursed or under-reimbursed inter-entity costs will not always have the same degree of usefulness for all levels of management. However, as stated in the standard on full costs, to fully account for the costs of the goods and services they produce, reporting entities will need to include the cost of goods and services received from other entities. Cost reduction and control, performance evaluation, and process improvement depend on knowledge of the full costs of producing outputs, including production costs incurred by other federal entities. These costs are most important for use by the entity's top-level management (and to a lesser degree by line managers) in controlling and assessing the operating environment and in making decisions about how best to acquire those goods and services. Knowledge of full cost, including the extent of inter-entity costs, is also important to external users, especially the Congress and taxpayers, in making decisions concerning various programs and allocating resources throughout the government.

229. In addition, the Board believes that, without the recognition of non-reimbursed and under-reimbursed inter-entity costs, the receiving entity has little incentive to control the use of these resources. While they may appear to be "free" to the receiving entity, the costs are absorbed somewhere in the government. If the receiving entity were charged for these costs, top-level management would then have more incentive to economize and control the use of these resources as well as make better decisions concerning how and where to acquire them. This would help reduce overall costs to the taxpayer and provide the other benefits associated with full-costing by responsibility segment.

230. The recognition of all inter-entity costs is also important when an entity produces goods or services that are sold outside of the federal government. For the entity to recover the government's full cost on the sale, knowledge of the total cost, including costs incurred by other federal entities, is vital to the establishment of an appropriate price.

The Use of Estimates

231. The standard places the responsibility on the providing entity to supply the receiving entity with information on the full costs of non-reimbursed or under-reimbursed inter-entity goods and services. This is appropriate since only the providing entity is likely to have such information. Implementation of the standard on full costing should make this requirement fairly easy for the providing entity to fulfill. If, for some reason, the providing entity cannot or does not supply the cost information, the receiving entity has no way to recognize the costs other than through estimation.

232. The Board anticipated this possibility, and requires the receiving entity to use an estimate of the cost of those goods and services if the actual cost information is not provided. The estimate must be reasonable and should be aimed at determining realistic costs incurred by

the providing entity. However, if such a cost estimate cannot be made, the receiving entity may base the estimate on the market value of the goods or services.

233. Some respondents to the exposure draft stated that the use of estimates would be too problematic and unreliable and that the receiving entity would not have enough information to make the estimate. Some were concerned that the use of estimates would cause arguments between reporting entities over the cost. Others were concerned that some entities do not have experienced personnel to make such estimates. A few were concerned about the audit implications of using an estimate.

234. Some respondents expressed concern over the possible use of market values in making the estimate. Some of these respondents stated that government-type goods and services are not often produced outside government and, therefore, such market values may not exist. Others stated that market value does not always bear a direct relationship to true cost or that market values change too rapidly to be of any use.

235. The Board realizes the problems associated with the use of estimates. However, implementation of the other managerial cost accounting standards in this statement by the providing entities should considerably lessen the need for receiving entities to make estimates of inter-entity costs. The Board also believes that, if the inter-entity costs meet the recognition criteria established by the standard, and cost information is not received, then use of a reasonable estimate of cost is preferable to no recognition at all.

236. Estimates are often used in accounting and financial reporting. The recognition of cost based on estimation is not new and can be reliable so long as the estimate is reasonable and based on a rational and systematic method. The Board also realizes that the use of estimation necessarily implies the use of professional judgement. This does not negate the value of the estimate to users of the financial information and should not present a problem in relation to audit requirements.

237. The Board realizes that market values may not always be available for many kinds of inter-entity goods and services. Nevertheless, if such values are available, they can be a good basis for estimating cost if no other basis can be established. Although market values may not be directly related to costs of production and they may fluctuate, they may also be viewed as a fairly reliable guide to the costs an entity might have to incur to obtain inter-entity goods and services from a non-governmental source. As with the determination of all estimates, use of market values as an estimation basis requires the use of judgement and professional care.

238. The Board also realizes that there may be some implementation problems such as disagreements with providing entities over an estimated cost or with the lack of trained personnel to make estimates. These problems are of a practical nature and can be resolved

by management. In that regard, they are not unlike other problems faced when implementing any new or changed accounting standard such as making changes to systems and methods and training personnel on the new requirements. Both providing and receiving entities should work closely with each other to resolve any costing problems just as they would to solve any non-accounting related situations.

Recognition Criteria

239. It is clear to the Board that the recognition of each and every non-reimbursed or under-reimbursed inter-entity cost is not possible. The federal government is a very large and complex entity and it is normal to expect some flow of goods and services between its activities as a natural and reasonable method of completing missions and objectives. The Board decided that only certain non-reimbursed or under-reimbursed inter-entity costs should be addressed. The standard, therefore, includes criteria for recognition which will limit the application of the standard to only those items deemed most significant and important.

240. The criteria address the materiality of the non-reimbursed inter-entity cost, whether it is a part of broad and general support for all entities, and whether it is needed to help determine a price to non-governmental entities. The materiality criterion considers materiality in the context of the importance of the item to the receiving entity. Under this criterion, whether an item of inter-entity cost is recognized depends upon three points. The first of these is significance to the receiving entity, i.e. whether the item is important enough that management should be aware of its cost in decision making circumstances. The second is the degree to which the goods or services are an integral and necessary part of the receiving entity's output. The third is the degree to which the good or service can be matched to the specific receiving entity with reasonable precision.

241. The criterion of broad and general support recognizes that some entities provide support to all or most other federal entities, generally as a matter of their mission. The costs of broad and general services should not be recognized by the receiving entity when no reimbursement has been made. However, if the service is an integral and necessary part of the receiving entity's operations and outputs, those costs should be recognized.

242. The criteria also recognize that there are certain cases in which inter-entity costs need to be recognized because there could be an effect upon a resulting price to a non-governmental entity. If a federal entity sells outputs to a non-federal entity, it is usually required to recover the full cost of those goods or services. While cost is not the sole determinant of final price, knowledge of the actual full cost of production to the government as a whole is necessary to ensure that the price is appropriately established at a level that will recover all costs.

243. Most of the respondents to the exposure draft agreed with the recognition criteria. However, a few were concerned about how the criteria might be interpreted and whether the standards were too general in nature. The Board realizes that considerable judgement is required to apply these criteria and notes that the specific facts and circumstances in each case must be considered. This concern, along with other implementation concerns, led the Board to make certain decisions about implementation discussed below under "Implementation Issues."

Consolidation

244. The standard requires that, when non-reimbursed or under-reimbursed inter-entity costs are recognized, the receiving entity should recognize the full costs of the goods or services received as an expense (or asset) and, to the extent that reimbursement is less than full cost, the difference is to be recognized as a financing source. At the same time, of course, the providing entity would continue to recognize the full costs of goods and services provided, and any off-setting reimbursements, in its accounting records. Several respondents to the exposure draft were concerned about the possibility of "double-counting" of costs and others raised concerns about the ability to eliminate these transactions in consolidations.

245. Both the providing entity and the receiving entity are separate reporting entities. Each should recognize in its accounting records and financial reports the true costs of operations and any revenues received. The providing entity incurs a cost in providing the goods or services even though they are sent to another entity. It may also receive a partial payment or reimbursement. These transactions and events should be reflected in its accounting. The receiving entity, as a separate reporting entity, should also recognize its total cost of production. The full cost of non-reimbursed or under-reimbursed goods or services ultimately contributing to its outputs should be reflected in the costs of production. To the extent that reimbursement is not made for those costs, the receiving entity is utilizing a separate source of financing, namely the providing entity. Again, this fact is reflected in the accounting. The result is that costs recognized but not actually paid are off-set by the imputed financing source. While the entity's financial position is not affected, the real costs of production are reflected.

246. The only possibility for "double-counting" of costs occurs when consolidated financial reports are prepared for a reporting entity that includes both the providing entity and the receiving entity. In preparing such statements, the standard calls for elimination of the inter-entity transactions. In effect, this is no different from the elimination of transactions for which full reimbursement has been made. The only additional transaction to be eliminated is the recognition of the imputed financing source by the receiving entity. The recognition of costs by both the providing entity and the receiving entity and any actual reimbursements would be eliminated anyway if payment for the inter-entity costs were made.

247. The Board realizes that identification and tracking of transactions that must be eliminated for consolidated reports can become complex and difficult. However, this is a practical implementation problem that management should be able to overcome through the use of transaction coding or some other identification method. It likely will require changes in methods and systems currently in use and may require additional training of personnel. The Board has decided upon a method to ease implementation problems as discussed below.

Implementation Issues

248. As discussed above, the Board realizes that there may be problems in implementing the standard on inter-entity costing. Recognition of non-reimbursed or under-reimbursed inter-entity costs is a new concept to federal entities and involves a new way of thinking about costs. There is concern that application of the standard may be inconsistent among federal entities. In addition, there could be problems, particularly at first, in developing estimates of costs; in revising accounting systems and procedures to accommodate these requirements; and in training personnel to accomplish the task. Furthermore, the Board recognizes the concern that some have about the elimination of inter-entity cost transactions for consolidated reporting since the accounting procedures may be complicated.

249. As a result of these problems and concerns, the Board has expressed the need to take a measured, step-by-step, practical approach to implementation of this standard. Therefore, the Board has decided that, in implementing the standard, it recommends that OMB, with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing and OMB should then issue guidance identifying those costs. OMB should consider the requirements of the standard including the recognition criteria in developing the guidance and it should also consider suggestions and information provided by Treasury, GAO, and other agencies. The Board anticipates the largest and most important inter-entity costs will be identified first, followed by others as entities gain experience in the application of the standard. This approach is seen as a practical way to ensure uniformity in the application and implementation of the standard and to provide time and experience in overcoming any other practical problems which may arise. Also, the Board may recommend specific inter-entity costs for recognition in possible future recommended standards.

Costing Methodology

250. The ED discussed cost accumulation and assignment principles. The ED states that costs should be accumulated by responsibility segments, and the accumulated costs should be classified by type of resource such as costs of employees, material, capital, utilities, rent, etc. The ED states that "The accumulation of costs by responsibility segments does not mean that each responsibility segment must have its own accounting system. The reporting

entity may have a centralized accounting system, but the system should be capable of identifying costs with responsibility segments.” (See ED par. 170)

251. The ED discussed three cost assignment principles: (a) directly tracing costs wherever feasible and economically practical, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis. These principles apply to costs of services provided by a segment to other segments, as well as assigning costs to ultimate outputs of a segment.

252. The ED then provided brief descriptions of available costing methodologies: activity-base costing (ABC), job order costing, process costing, and standard costing. The ED pointed out that these costing methodologies are not mutually exclusive. For example, standard costing can be used within ABC. ABC and standard costing combined can then be used with either job order costing or process costing.

253. Most respondents believed that the requirement for cost accumulation by responsibility segment is appropriate. Some of them stated that costs are accumulated at levels lower than segments such as cost centers, processes, or activities within a segment. Such accumulation is consistent with the standard so long as the costs will be aggregated at the segment level. Some of the respondents stated that the requirement is currently feasible because their systems are designed to accumulate expenses by segments and by resource types. Others, however, stated that they must upgrade their general accounting systems in order to meet the standard requirement.

254. All the respondents agreed with the cost assignment principles. One respondent, while supporting the principles, stated that the principles should be explicitly ranked by preference. The Board intended to express an preference among the principles. It stated in the proposed standard that direct cost tracing should be used “wherever it is feasible and economically practical.” The Board further stated in the ED that “for the costs that are not directly traced to outputs, it is preferable that they be assigned to them on a cause-and-effect basis.” (See ED par. 182) However, for cost-benefit considerations, assigning costs by allocations cannot be avoided. The Board emphasized that cost allocations should be performed on a rational basis. It also cautioned that allocations can be arbitrary and thus may result in distortions. (See ED par. 190) To make the intent of preference more explicit, the Board has added words to the standard to indicate that the principles are listed by preference.

255. All the respondents approved the descriptions of available costing methodologies. Some of them stated that the materials included are clear and provide adequate guidance. The respondents agreed with the Board’s position that because federal activities are highly diverse, it is not practical to require a particular costing method for a particular type of

activity at this time. However, it is appropriate to require that each entity select a costing methodology that is best suited to its operations and use that methodology consistently.

256. The Board encouraged government entities to study the potential use of ABC in their operations (ED par. 200). This was well received by the respondents. Eighteen respondents supported ABC. Most of them said that ABC can be effective when combined with any of the other costing methodologies. Seven respondents from federal agencies stated that they believed ABC is appropriate for their activities and were considering using it. In addition, two respondents stated that the use of standard costing should also be encouraged. The Board continues to believe that as federal agencies are going through stages in the development of their managerial costing, more sophisticated and refined costing methods, such as ABC and standard costing, should be considered and used to minimize arbitrary cost allocations and to improve full cost information.

257. The Board considered whether the costing methodology section should be recommended as a concept or a standard. It concluded that it should be a standard. The Board believes that cost accumulation and assignment principles contained in this section are definitive and should be followed by federal entities. Only by adhering to the principles and by continuous refinement of costing methodologies, can reliable full cost information be achieved.

Unused Capacity Costs

258. The ED proposed a standard, which, if adopted, would have required that entities measure the cost of unused operating capacity and report it as a separate expense. For this purpose, some entities, such as DoD, must separate operating capacity from “readiness capacities” which are reserved for war and emergency mobilization rather than normal operations. The operating capacity can be measured in terms of “practical capacity” which is the maximum units of output that the available capacity can produce taking the normal stoppage and interruptions into consideration. Unused capacity is the excess of practical capacity over actual outputs.

259. A number of respondents appreciated the importance of the proposed requirement. They stated that capacity cost information would be very useful in improving the cost and capacity management of federal agencies. Several respondents from the private sector urged that the proposal be adopted immediately.

260. Most respondents from federal agencies, however, stated that capacity measurements involve very complex issues and are not feasible to implement at this time. If the proposed requirement were adopted, agencies would encounter two major types of difficulties. First, they lack guidance on defining and measuring various types of capacity. For example, respondents from DoD stated that it is difficult to develop criteria that can be used to

differentiate defense operating capacity costs from mobilization capacity costs. Civilian agencies engaging in administrative, policy making, and regulatory activities also indicated difficulties in defining their practical capacities. Second, respondents of many agencies stated that they do not have the accounting capability to provide reliable capacity measures. Without such capability, unused capacity costs could be improperly estimated and the resulting information could be misleading.

261. Many respondents were also opposed to the proposed standard on the basis of cost-benefit considerations. They estimated that accounting for capacity costs would require substantial time and efforts to implement. This would require the use of their limited accounting personnel and equipment. Respondents from some agencies do not perceive that they have an over-capacity problem. Thus, it is very uncertain whether capacity accounting results, if produced, could be used to improve their operations.

262. After considering the responses to the ED, the Board is convinced that it is premature to recommend capacity accounting either as a standard or as a concept. The Board is aware that federal agencies have limited personnel and other resources for accounting. They must devote those limited resources to improving general financial reporting and to establishing the more fundamental elements of managerial cost accounting. Thus, it would not be cost beneficial to implement capacity costing at this time.

263. Managing capacity costs is a part of cost management. Although this document does not recommend a standard for measuring capacity costs, the full cost information required by the full cost standard will help management in identifying capacity utilization problems. Some respondents stated that the capacity accounting concepts would be useful to capital intensive, industrial-type activities and activities that deliver repetitive services that are measurable in units. The Board is aware that there are on-going research efforts on the subject in the private accounting communities. Thus, the Board may reconsider capacity accounting in the future.

Effective Date

264. The Board holds the view that managerial cost accounting has been needed across the federal government for a long time. Since the standards are quite general and address only the highest levels of cost accounting, the Board felt that they should be implemented quickly. The earlier managerial cost accounting is started, the earlier the benefits will be seen in managing and controlling federal programs and activities. The Board also believes that an effective date far into the future would not serve to quickly change the government's tendency to neglect cost accounting. Therefore, in the exposure draft, the effective date was set for fiscal periods beginning after September 30, 1995 (i.e., beginning in fiscal year 1996).

265. A majority of respondents to the exposure draft commented that this date was too early and said that they foresee problems with implementation at September 30, 1995. Many reasons were given for a delay in implementation. Chief among these were (1) difficulty in obtaining funding to make necessary changes in financial systems before September 30, 1995, (2) a lack of trained accounting personnel and equipment, and (3) a need for time to develop or modify appropriate cost accounting methodologies and systems and develop management awareness and support. Respondents suggested implementation dates ranging from one to five years after the fiscal year 1996 date given in the exposure draft.

266. The Board recognized the validity of the concerns of many respondents over funding, training, and development of costing activities. However, it also recognized that federal agencies must be able to develop cost information very soon to meet the requirements of the GPRA. It also noted that reporting entities do not have to possess sophisticated cost accounting systems to meet the requirements in these standards. 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 term.

267. Nevertheless, the Board agreed that the implementation date in the exposure draft may be a problem for many federal agencies since cost accounting is relatively new to most of them and the recommended implementation date is very near. The Board decided, therefore, to delay the implementation date by one additional year and make the standards effective for periods beginning after September 30, 1996, with earlier implementation encouraged.

Glossary

268 Early on in the development of the managerial cost accounting project, the task force determined that many problems can result in cost accounting from the use of similar terms to mean different things. It concluded that the use of consistent cost accounting terminology is necessary to avoid confusion and mis-communication. Therefore, it recommended that the Board attach a glossary to the exposure draft which would define many of the cost accounting terms used.

269. The Board agreed with this recommendation. It also decided that the establishment of uniform cost accounting terminology within the federal government is so important that the glossary should contain not only definitions for terms used in the statement, but also definitions for other important cost accounting terms even if those terms are not used directly in the text of the statement. This glossary would serve as the beginning of a uniform and consistent cost accounting terminology for use within the federal government.

270. Comments were received from only one respondent to the exposure draft concerning the glossary. That respondent did not suggest changing any of the definitions provided in the

glossary, but only suggested some additions. The Board decided that the glossary is sufficient for the time being and should be retained in the final statement as an appendix. However, it also decided that it may issue additions to the glossary at a later date as more federal agencies gain experience in the development of cost information, and as the need for additional standard definitions becomes apparent.

Appendix B: Glossary

See Consolidated Glossary in "Appendix E: Consolidated Glossary."

Statement of Federal Financial Accounting Standards 5: Accounting for Liabilities of The Federal Government

Status

Issued	December 20, 1995
Effective Date	for fiscal years beginning after September 30, 1996.
Affects	• SFFAS 1, by amending the definition of "liability".
Affected by	• SFFAS 7, paragraph 36(b), affects SFFAS 5, paragraphs 35-42. • SFFAS 8, paragraphs 116 & 117 affect SFFAS 5, paragraphs 6, 104 and 105. • SFFAS 12 affects SFFAS 5, paragraphs 33 and 36. • SFFAS 17 affects SFFAS 5, paragraphs 6, 104, and 105. • Interpretation 3 affects SFFAS 5, paragraphs 56-76. • Interpretation 4 affects SFFAS 5, paragraphs 71, 74, and 75. • SFFAS 25, paragraph 4, affects SFFAS 5, paragraph 106. The Executive Summary is also affected. • SFFAS 32 amends paragraphs 117 and 121. • SFFAS 33 amends paragraphs 65, 66, 83, 95 and 157. • SFFAS 39 amends footnote 17. • SFFAS 51 rescinded paragraphs 97-121. • TB 2017-1 clarifies SFFAS 5.
Related Guidance	• Interpretation 2, *Accounting for Treasury Judgment Fund Transactions* • Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* • Interpretation 4, *Accounting for Pension Payments in Excess of Pension Expense* • Interpretation 9, Cleanup Cost Liabilities Involving Multiple Component Reporting Entities • TR 1, *Audit Legal Letter Guidance* • TR 2, *Environmental Liabilities Guidance* • TR 12, *Accrual Estimates for Grant Programs*

Summary

This Statement establishes accounting standards for liabilities of the federal government not covered in Statement of Federal Financial Accounting Standards 1, *Accounting for Selected Assets and Liabilities*, and in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*. This Statement defines "liability" as a probable future outflow or other sacrifice of resources as a result of past transactions or events.[1]

This Statement defines the recognition points for liabilities associated with different types of events and transactions (See Figure 1 on page 6).[2]

- A liability arising from reciprocal or "exchange" transactions (i.e., transactions in which each party to the transaction sacrifices value and receives value in return) should be recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., a federal employee performs services in exchange for compensation).
- A liability arising from nonreciprocal transfers or "nonexchange" transactions (i.e., transactions in which one party to the transaction receives value without directly giving or promising value in return, such as grant and certain entitlement programs) should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services[3] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (e.g., estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).
- Government-related events are nontransaction-based events that involve interaction between federal entities and their environment. The event may be beyond the control of

[1]Liabilities recognized according to the standards in this Statement include both liabilities covered by budgetary resources and liabilities not covered by budgetary resources. Liabilities covered by budgetary resources are liabilities incurred that will be covered by available budgetary resources encompassing not only new budget authority but also other resources available to cover liabilities for specified purposes in a given year. Liabilities not covered by budgetary resources include liabilities incurred for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or current earnings of the reporting entity. Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress. (Adapted from OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements.")

[2]Recognition means reporting a dollar amount on the face of the basic financial statements.

[3]Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

the entity. A liability is recognized for a future outflow of resources that results from a government-related event when the event occurs if the future outflow of resources is probable and measurable (see paragraphs 33 and 34 for the definitions of probable and measurable, respectively) or as soon thereafter as it becomes probable and measurable. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damage and to the extent that the amount of the payment could be estimated reliably. Government-related events also include hazardous waste spills on federal property caused by federal operations or accidents and catastrophes that affect government-owned property.

- Government-acknowledged events are events that are of financial consequence to the federal government because it chooses to respond to the event. A liability is recognized for a future outflow of resources that results from a government-acknowledged event when and to the extent that the federal government formally acknowledges financial responsibility for the event and a nonexchange or exchange transaction has occurred. The liability for a nonexchange transaction should be recognized for any unpaid amounts due as of the reporting date and the liability for the an exchange transaction should be recognized when goods or services have been provided. The liability includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (Examples of government-acknowledged events include toxic waste damage caused by nonfederal entities and damage from natural disasters).

In addition to discussing the general liability recognition principle, the Statement includes several specific federal liability accounting standards which are summarized below.

- *Contingencies*—A contingency is 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. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized, may be disclosed[4], or may not be reported at all, depending on the circumstances.[5] Contingencies should be recognized as a liability when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice

[4]"Disclosure" in this document refers to information in notes regarded as an integral part of the basic financial statements.

[5]In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred. 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.

- *Capital leases*—See SFFAS 54.[6]

- *Federal debt*—Federal debt transactions are recognized as a liability when there is an exchange between the involved parties. Fixed-value securities are securities that have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) values net of any unamortized discount or premium. Amortization of the discount or the premium should normally follow the interest method; in certain cases, the straight line method is permitted (see page 16). Variable-value securities should be originally valued and periodically revalued at their current value on the basis of the regulations or offering language. The related interest cost of the federal debt includes the accrued (prorated) share of the nominal interest incurred during the accounting period, the amortization amounts of discount or premium of each accounting period, and the amount of change in the current value for the accounting period for variable-value securities.

- *Pensions, other retirement benefits, and other postemployment benefits*—The liability and associated expense for pensions and other retirement benefits (included health care) should be recognized at the time the employee's services are rendered. The expense for postemployment benefits should be recognized when a future outflow or other sacrifice of resources is probable and measurable based on events occurring on or before the reporting date. Any part of that cost unpaid at the end of the period is a liability. The aggregate entry age normal actuarial cost method should be used to calculate the expense and the liability for the pension and other retirement benefits for the administrative entity financial statements, as well as the expense for the employer entity financial statements. The employer entity should recognize an expense and a liability for postemployment benefits when a future outflow or other sacrifice of resources in probable and measurable on the basis of events that have occurred as of the reporting date.

[6]See SFFAS 54.

- *Insurance and guarantee programs*—All federal insurance and guarantee programs[7] (except social insurance and loan guarantee programs[8]) should refer to SFFAS 51 for guidance.

[7]Social insurance in considered to be a separate program type not included within insurance and guarantee programs. See social insurance discussion in [SFFAS No. 17, Accounting for Social Insurance].

[8]Accounting for federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees (August 23, 1993).

Figure 1: Liability Recognition Summary

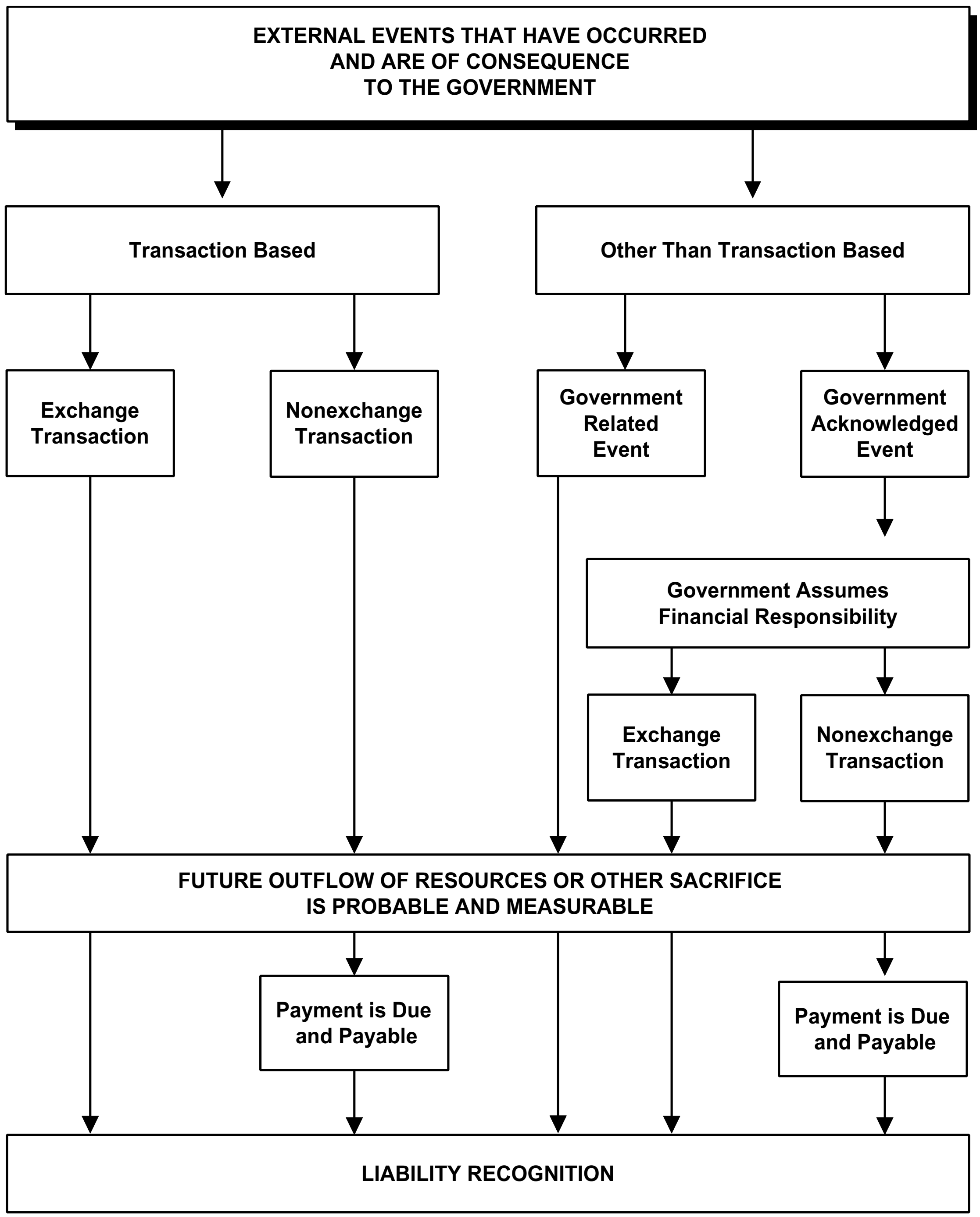


Table of Contents

Purpose

1. The purpose of this Statement is to establish accounting standards to recognize and measure liabilities in general purpose federal financial reports, which are issued for both internal and external users. Appendixes provide background, rationale, and examples of how to apply this standard to liabilities associated with federal programs' transactions and events.

Scope

2. This Statement articulates a general principle that should guide preparers of general purpose federal financial reports. It also provides more detailed guidance regarding liabilities resulting from deferred compensation, insurance and guarantees (except social insurance), certain entitlements, and certain other transactions. The Statement addresses liabilities not covered in Statement of Federal Financial Accounting Standards (SFFAS) Number 1, *Accounting for Selected Assets and Liabilities*, and in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*.

3. The concept of a liability in this document is consistent with those in Statements Number 1 and 2. The definition amends the stated definition of a liability in SFFAS Number 1. This Statement establishes accounting for liabilities not covered in SFFAS No. 1 and 2. Statement Number 1 addresses only those selected liabilities that routinely recur in normal operations and are due within a fiscal year. The liabilities covered in Statement Number 1 are accounts payable, interest payable, and other current liabilities, such as accrued salaries, accrued entitlement benefits payable, and unearned revenue.[1]

4. Statement Number 2 addresses liabilities specifically arising from direct loans and loan guarantees. Loan guarantees are "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 they do not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions."[2]

[1]Adapted from Statement of Federal Financial Accounting Standards (SFFAS) Number 1, *Accounting for Selected Assets and Liabilities* (March 30, 1993), par. 96.

[2]OMB Circular No. A-11 as cited in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees* (August 23, 1993), p. 46.

5. The general conceptual definition of “liability” underlying this Statement is similar in some respects to that articulated by the Financial Accounting Standards Board (FASB) but the FASAB made certain modifications to the private sector concept to apply it within the federal context. Also, as is explained in the Basis for Conclusions, the specific standards dealing with pensions, other retirement benefits, and postemployment benefits differ from those the FASB has published.

6. This Statement requires certain disclosures about existing liabilities. The Statement, however, does not fully address information about stewardship responsibilities, including social insurance,[3] related to future financial reporting periods. Such information may be reported in a supplementary stewardship report, pursuant to standards now being developed (see FASAB’s ED, Supplementary Stewardship Reporting). Information about projected future outflows is vital to making informed decisions about public policies, including the level of benefits promised under current law and the level of revenues/premiums required to liquidate the liability (if any).

7. The recognition of social insurance programs[4] presented the Board with significant theoretical and practical problems. The exposure process for the draft liability standard brought forth strongly held positions about social insurance. Upon reconsideration of the issues the Board concluded that, regardless of the technical merits of the arguments concerning the nature of social insurance programs, it was questionable whether adequate information concerning social insurance could be presented by means of a single, point-in-time number on a Balance Sheet. The Board modified the draft standard so it would require several measures of social insurance to be presented. The Board decided that, given the sensitivity and magnitude of social insurance, the new proposal should receive additional exposure to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and presented in the *Supplementary Stewardship Reporting* Exposure Draft. (For more details see the Basis for Conclusions).

Objectives Of Federal Financial Reporting

8. When developing accounting standards for the federal government, the significant environmental differences between the federal government and the private sector must be

[3]Stewardship responsibilities are further discussed in *Supplementary Stewardship Reporting*.

[4]Social insurance programs are income transfer programs financed by compulsory earmarked taxes and in certain cases also include general revenues of the federal government.

kept in mind. Statement of Federal Financial Accounting Concepts Number 1, *Objectives of Federal Financial Reporting*, discusses the federal accounting and financial reporting environment. It notes the following:

The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

9. The objectives of federal financial reporting were designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government. The four objectives are discussed under the headings (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control. These objectives were used as a basis to develop the Liability Statement. The Board believes that the operating performance objective has special relevance to decisions about recognition and measurement of liabilities in general purpose federal financial reports. That objective reads as follows:

Federal financial reporting should assist report users in evaluating the service efforts, cost, 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.[5]

10. At the same time, the Board recognizes that the third objective, dealing with stewardship, is equally important.

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 conditions have changed and may change in the future.

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.

Examples of information relevant to this objective include:

[5]Statement of Federal Financial Accounting Concepts Number 1, *Objectives of Federal Financial Reporting* (Sept. 2, 1993).

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations[6] (such as the probable cost of deposit insurance).

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses.

Entity And Display

11. SFFAC Number 2, *Entity and Display*, is a concept statement that provides a framework for defining the meaningful reporting units for general purpose federal financial reports with consideration of the relationships among the budgetary, organizational, and programmatic units. The Concepts Statement also describes in general terms the nature of general purpose federal financial reports, including their names and formats. Agreement on the concepts of entity and display is necessary to establish standards for presenting general purpose federal financial reports.

12. The Entity and Display and Liability Statements are interrelated in several ways. Decisions on each affected the other. For example, the Entity and Display Concept Statement suggests what reporting units should report liabilities and, in general terms, how these liabilities should be displayed. The provisions of the Concept Statement that contemplate presentation of information about future stewardship responsibilities as well as information about events and transactions that have occurred are related to the selection of events and transactions to be recognized.[7]

Effective Date

13. The accompanying standards presented in this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

Structure Of This Document

14. This document has three sections, two appendixes, and a glossary. The first section, the executive summary, precedes this section. This introduction constitutes the second section. The remaining section and appendixes are described below.

Liability Standards

[6]The term “obligation” is used in its everyday or generic sense, not as it is used in federal budgetary accounting.

[7] See Statement of Federal Financial Accounting Concepts (SFFAC) Number 2, Entity and Display (April 20, 1995).

15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, capital leases, federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

Appendix A: Basis for Conclusions

16. This appendix summarizes considerations that members of the Board deemed significant in reaching the conclusions in the Statement.

Appendix B: Liability Recognition and Measurement Matrix

17. The Liability Recognition and Measurement Matrix illustrates the measurement attributes and recognition points for several transactions and events.

Appendix C: Glossary

Glossary [omitted -- see Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1]

18. The glossary defines various terms used in this Statement.

Liability Standards

Definition And General Principle For Recognition Of A Liability

19. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize[8] probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.[9]

Events And Transactions

20. The existence of a past event (which includes transactions) is essential for liability recognition. An event is a happening of financial consequence to an entity.[10] An event may be an internal event that occurs within an entity, such as transforming raw materials into a product. An event may also be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, a theft, vandalism, an injury caused by negligence, or an accident.

21. As the term is used in this Statement, a **transaction** involves the transfer of something of value. Transactions may be either exchange transactions or nonexchange transactions. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting.

22. An **exchange transaction** arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. 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.[11]

23. An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future

[8]Recognition means reporting a dollar amount on the face of the basic financial statements .

[9]This document uses the term “nonexchange transaction” in a way similar to FASB’s “nonreciprocal transfer.” That is, it implies a one-way flow of resources, services, or promises between two parties. “Transaction” in the phrase “nonexchange transaction” does not include reclassification, closing, and similar “internal” entries to the accounting records, though some accountants use the term in that broader sense. “Probable” means more likely than not. “Measurable” means reasonably estimable.

[10] “Consequence” is defined as something of importance or significance.

[11]Executory contracts where goods and services have not been received are not generally recognized as liabilities in financial accounting, although they are generally recognized as obligations in governmental budgetary accounting.

retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs. The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.

24. A **nonexchange transaction** arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services[12] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity) .

25. Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

26. An **event** is defined as a happening of financial consequence to an entity. For federal financial reporting, some events may be other than transaction based and these events may be classified in one of two categories: (1) government-related events or (2) government-acknowledged events.

27. **Government-related events** are nontransaction-based events that involve interaction between the federal government and its environment. The event may be beyond the control of the federal entity. In general, a liability is recognized in connection with government-related events on the same basis as those that arise in exchange transactions. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably.[13]

[12]Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

[13]The vast majority of claims against the United States Government stemming from tortious government conduct are adjudicated under the Federal Tort Claims Act (FTCA), which provides for both administrative and judicial resolution. Administrative awards under the established threshold are paid from agency appropriations. Administrative awards in excess of the established threshold are paid from the judgment appropriation. Court judgments and compromise settlements by the Department of Justice are paid from the judgment appropriation regardless of amount. This Act means that, for certain types of events it is not necessary for the government to acknowledge financial responsibility separately for each individual event as is the case for events described in paragraph 30.

28. Government-related events include:

(1) cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations, that are in effect as of the Balance Sheet date, to clean up (i.e., remove, contain, or dispose of);[14]

(2) accidental damage to nonfederal property caused by federal operations; and

(3) other damage to federal property caused by such factors as federal operations or natural forces.[15]

29. Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.

30. **Government-acknowledged events** are those nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event. 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.

31. Consequently, costs from many events, such as toxic waste damage caused by nonfederal entities and natural disasters, may ultimately become the responsibility of the federal government. But these costs do not meet the definition of a "liability" until, and to the extent that, the government formally acknowledges financial responsibility for the cost from the event and an exchange or nonexchange transaction has occurred. In other words, the federal entity should recognize the liability and expense when both of the following two criteria have been met (1) the Congress has appropriated or authorized (i.e., through authorization legislation) resources and (2) an exchange occurs (e.g., when a contractor performs repairs) or nonexchange amounts are unpaid as of the reporting date (e.g., direct payments to disaster victims), whichever applies.

32. The following example illustrates the liability recognition of government-acknowledged events. A tornado damages a U.S. town and the Congress appropriates funds in response to the disaster. This event is of financial consequence to the federal government because the federal government chooses to provide disaster relief to the town. Transactions resulting from this appropriation, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or

[14]See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, for a detailed discussion of cleanup cost.

[15]The subjects of valuing assets and of measuring asset impairments--thus measuring the loss to be recognized--are beyond the scope of this Statement. See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, for a discussion on the impairment or loss of federal property.

nonexchange transactions. In the case of exchange transactions, amounts payable for goods and services provided to federal entities are recognized when the goods are delivered or the work is done. In the case of nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.

Probable Future Outflow Or Other Sacrifice Of Resources

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 with the exception of pending or threatened litigation and unasserted claims.[15a] 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.[16]

Measurability

34. "Measurability" means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable. Liabilities reported in the financial report are measured by different attributes specified by various accounting standards. Several different measurement attributes are used for different items in present practice (e.g., fair market value, current cost, present value, expected value, settlement value, and historical cost).

[15a]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.

[16]See Statement of Federal Financial Accounting Standards Number 1, *Accounting for Selected Assets and Liabilities*, (March 30, 1993), app. A, par. 95.

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).[17]

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 incurrence 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, 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.

- Reasonably possible: The chance 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:

- collectability of receivables,

- pending or threatened litigation, and

- possible claims and assessments.

[17]Contingencies are different from "subsequent events." Subsequent events are events or transactions that affect the basic information or required supplementary information (RSI) and occur subsequent to the end of the reporting period but before the financial report is issued. Some of those transactions and events (referred to as recognized events) require adjustments to the basic information or RSI while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI. A subsequent event may affect a contingency by providing information that resolves an uncertainty related to a contingent liability and confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

Criteria For Recognition Of A Contingent Liability

38. A contingent liability should be recognized when all of these three conditions are met:[18]

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).[19]
- 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 likely to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount). [See SFFAS 12.]

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 statements.

[18]The unit of analysis for estimating liabilities can vary according to the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, SFFAS Number 2, "applies 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." Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*. par. 21. See the standard on Insurance and Guarantees in this document for a description of incurred but not reported (IBNR) claims.

[19]In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

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.

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.

See SFFAS 7, par. 36b, for guidance on losses on contracts for goods made to order or services produced to order

Capital Leases

43. **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.

44. The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.[20] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.

45. The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

46. During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability.[21]

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SFFAS 54, Leases, as amended by SFFAS 58, will replace the requirements for lease accounting established in SFFAS 5 paragraphs 43-46 and the related footnotes, 20-21.

SFFAS 5 paragraphs 43-46 will be rescinded for reporting periods beginning after September 30, 2023.

[20]"The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception." See SFFAS No. 6, Accounting for Property, Plant, and Equipment.

[21]OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.

Capital Leases

43. [See SFFAS 54 for revised standards regarding leases].

44. [See SFFAS 54 for revised standards regarding leases].

45. [See SFFAS 54 for revised standards regarding leases].

46. [See SFFAS 54 for revised standards regarding leases]. [20,21]

[20] [Footnote 20 rescinded by SFFAS 54.]

[21] [Footnote 21 rescinded by SFFAS 54.]

Federal Debt And Related Interest Cost

47. This standard applies to all securities or other debt instruments issued by the U.S. Treasury or other federal agencies. It encompasses debt issued to the public and debt issued to federal accounts by other federal accounts.[22]

48. Accounting for the federal debt should identify the amount of the outstanding debt liability of the federal government at any given time and the related interest cost for each accounting period. This entails valuing securities initially at their sales price or proceeds, ultimately at the amount paid to the holder at maturity, and in the intervening period in a way that fairly expresses the federal government's liability.

Accounting For Federal Debt Securities

49. Federal debt securities[23] fall into two major categories for accounting purposes: fixed value securities and variable value securities.

[22]This includes but is not limited to debt issued by the U.S. Treasury to trust funds, agency borrowings from Treasury, and trust fund borrowings from other trust funds.

[23]Figure 2 lists various categories and examples of federal debt securities.

Fixed Value Securities

50. Fixed value securities have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) value net of any unamortized discount or premium. Securities sold at face (par) have no discount or premium and should be valued at face (par). Securities sold at a discount will increase in value between sale and maturity; securities sold at a premium will decrease in value. Amortization of the discount or premium may follow the straight line method or the interest method.[24] Either method is acceptable in the cases of

- short-term securities that have a maturity of 1 year or less, and
- longer-term securities for which the amount of amortization under the straight-line method would not be materially different from the amount of amortization under the interest method.

51. In all other cases, the interest method for amortizing any discount or premium should be used.

Variable Value Securities

52. Variable value securities 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. These securities should be originally valued and periodically revalued at their current value, on the basis of the regulations or offering language.

Related Interest Cost

53. The related interest cost of the federal debt include:

- the accrued (prorated) share of the nominal interest incurred during the accounting period,
- the amortization amounts of discount or premium for each accounting period (based on the same amortization method used to account for the related debt liability) for fixed value securities, and
- the amount of change in the current value for the accounting period for variable value securities.

[24]For an explanation and an example of the interest method of amortization, see Appendix B of SFFAS No. 1.

Retirement Prior To Maturity

54. For those securities that are retired prior to the maturity date due to a call feature of the security, or because they are eligible for redemption by the holder on demand, the difference between the reacquisition price and the net carrying value of the extinguished debt should be recognized currently in the period of the extinguishment as losses or gains.

Old Currencies Issued By The Federal Government[25]

55. Pursuant to federal law, old currencies issued by the federal government and not yet redeemed or written off are identified as a federal debt liability at face value and do not bear any interest.

[25]Old currencies include National and Federal Reserve Bank Notes, Old Demand Notes, Old Series currency, and silver certificates classified as public debt pursuant to 31 U.S.C. 5119.

Figure 2: Various Categories And Examples Of Federal Debt Securities[26]

Debt Category	Federal Debt Instruments			
	Subcategory	**Term**	**Redeemable**	**Accounting Method**
Marketable Debt	Treasury Bills	Up to 1 yr	At maturity	Liability at face value net of unamortized discount Straight line method of amortization of discount
	Treasury Notes	2 to 10 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
	Treasury Bonds	10 to 30 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
Non-Marketable Debt	Government Account Series:			
	Par Values	Various	On demand	Par value, no discount or premium to be amortized
	Market Based	Various	On demand	Liability at face value net of unamortized discount and premium Interest method of amortization of discount and premium
	U.S. Savings Bonds:			
	E/EE bonds	10 to 40 yrs	On demand after 6 months	Current value
	H/HH bonds	10 to 30 yrs	On demand after 6 months	Par value, no discount or premium to be amortized
	State & Local Government Securities	Various	On demand	Par value, no discount or premium to be amortized
	Domestic Series Zero-Coupon bonds	20 to 40 yrs	At maturity	Liability at face value net of unamortized discount Interest method of amortization of discount
	Foreign Series			
	Treasury bills	Up to 1 yr	On demand	Liability at face value net of unamortized discount Straight line method of amortization of discount
	Zero-Coupon bonds	20 to 30 yrs	At maturity (1 bond) On demand (2 bonds)	Liability at face value net of unamortized discount Interest method of amortization of discount Current value.

[26]These tables are intended to illustrate current practice only and are not to be considered authoritative.

Pensions, Other Retirement Benefits, And Other Postemployment Benefits

56. Employee benefits of federal civilian and military personnel and veterans[27] include pensions and postemployment and retirement benefits other than pensions. Pension plans[28] provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. The actuarially determined liability and expense of the plan, including all its provisions, is part of the pension plan's liability and expense estimate.

57. In addition to or in lieu of pension benefits, a liability for postemployment and other retirement benefits may be incurred outside the pension plan. Postemployment benefits other than pensions (OPEB) include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.[29] Inactive employees are those who are not currently rendering services to their employers and who have not been terminated, but who are not eligible for an immediate annuity, including those temporarily laid off or disabled. OPEB include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity.[30]

58. Retirement benefits other than pensions (ORB) are all forms of benefits to retirees or their beneficiaries provided outside the pension plan. Examples include health and life insurance. Retirement health care benefits are the primary ORB expense. They present unique measurement problems.

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[27]Veterans' compensation included in this category is a measurable program benefit that directly relates to a veteran's prior military service and is not the type of benefit included in general fund benefit programs. For example, compensatory income payments for injuries sustained in the line of duty (i.e., VA disability compensation benefits) are employee benefits, while entitlement benefits (i.e., VA pension) are accounted for as general fund benefits. (Also see Appendix A: Basis for Conclusions.)

[28]This standard addresses "defined benefit plans," which define the future benefits that will be paid in terms of such factors as age, years of service, or compensation. The amount of benefit depends on a number of future events incorporated in the plan's benefit formula.

[29]Special termination benefits (such as specially authorized separation incentive programs) are considered other postemployment benefits and should be recognized as such.

[30]The terms "employer entity" and "administrative entity" are used in this document to distinguish between entities that employ federal workers and thereby generate the employee costs, including pension cost, and those that are responsible for managing and/or accounting for the pension or the other employee plan. For example, entities that receive "salaries and expense" appropriations are employer entities, while the Office of Personnel Management is an administrative entity because it administers the civilian retirement benefit plans.

59. Pension benefits, OPEB, and ORB are exchange transactions because the employee performs service in part to receive the deferred compensation provided by the plans (such as future pension and medical care benefits). For pension and other retirement benefits, the expense is recognized at the time the employees' services are rendered. For OPEB, the expense is recognized at the time the accountable event occurs. Any part of that cost unpaid at the end of the period is a liability.

60. This Statement is intended to specify the accounting objectives. With regard to pensions and ORB, if estimates, averages, or such devices can reduce the cost of applying this Statement, their use is appropriate provided the results do not materially differ from a detailed application of the standard.

Pensions

61. Pension benefits include all retirement, disability, and survivor benefits financed through a pension plan, including unfunded pension plans. Federal civilian and military employees are covered primarily under the following three defined benefit retirement plans: Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS), and Military Retirement System (MRS). To the extent that federal employees are covered by social insurance programs (such as Social Security), the taxes they pay to the program and the benefits they will eventually receive are to be accounted for on the same basis used to account for other program participants. However, the payments to social insurance plans that agencies must make are operating costs. Similarly, to the extent that federal employees are covered by defined contribution plans (i.e., the Thrift Savings Plan, which is like a 401(k) plan), federal payments to the plan are expenses, but the plan itself is not covered under this standard.

62. This Statement establishes standards of accounting for pension expense and related pension liability for federal government employers and administrative agencies.

Accounting for the Pension Plan

63. This section covers federal pension plans. The entity that administers the plan (i.e., the "administrative entity") should account for and report the plan in accordance with this standard.[31] A subsequent section covers federal employer entities.

[31] In addition to the requirements of this standard, which deals with general purpose financial reports, federal plans report annually pursuant to P.L. 95-595, which calls for statements of net assets available for benefits, a statement of accumulated benefits, and other statements. The reporting requirements of Public Law 95-595 were rescinded by Public Law 105-362, Federal Reports Elimination Act of 1998.

64. **Attribution Methods**—The “aggregate entry age normal” actuarial cost method should be used to calculate the pension expense, the liability for the administrative entity financial statements, and the expense for the employer entity financial statements. The aggregate entry age normal method is one under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages; and it should be applied to pensions on the basis of a level percentage of earnings. The portion of this actuarial present value allocated to a valuation year is called the “normal cost.” The portion not provided for at a valuation date by the actuarial present value of future normal cost is called the “actuarial accrued liability.”[32] The plan, however, may use other actuarial cost methods if it explains why aggregate entry age normal is not used and if the results are not materially different.

65. **Assumptions**—For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS), actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4, Measuring Pension Obligations, as revised from time to time by the Actuarial Standards Board.[33] Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.

66. In addition to complying with the guidance in the preceding paragraph, the discount rate assumption for present value measurements of pension liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which cash flows are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates. The underlying inflation rate and the other economic assumptions should be consistent. The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury

[32]Adapted from Actuarial Standards of Practice No. 4, *Measuring Pension Obligations* (Jan. 1990), p. 31.

[33]The Actuarial Standards Board is a board within the American Academy of Actuaries that sets professional standards of actuarial practice.

securities. In developing the average historical Treasury rates, a minimum of five historical rates as of the appropriate reporting dates should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g. 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of the fiscal year 2007 for a payment due in 10 years, i.e., in 2017, a minimum of five 10-year Treasury rates should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one rate, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities for the years 2003 through 2007 were included in the average. The number of historical rates used for the average, e.g., five yearly rates, should be consistent from period to period. The entity should explain that its accounting policy is to be consistent in this regard from period to period. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.

67. The administrative entity should disclose the assumptions used. Administrative entities are encouraged to consult with one another to achieve the maximum consistency among assumptions used for financial reports. Smaller federal administrative entities may employ the assumptions used by any of the three primary plans where appropriate or their own assumptions. If they use assumptions that differ from all of the primary plans, a footnote should explain how and why the assumptions differ from one of those plans.

68. **Assets** should be reported separately from the pension liability rather than reporting only a net liability. Assets of federal pension plans should be carried at their acquisition cost, adjusted for amortization, if appropriate. For investments in market-based and marketable securities, the market value of the investment should be disclosed.[34]

69. **Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses**—Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior service. This results in a gain to the extent that previously recognized benefits are reduced. As explained in the next paragraph, the accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the pension liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

[34] See SFFAS Number 1, *Accounting for Selected Assets and Liabilities*.

70. The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.

71. **Accounting by the Administrative Entity**— The administrative entity should account for and report the pension liability in its financial report, using the aggregate entry age normal actuarial method. The liability is the actuarial present value of all future benefits, based on projected salaries and total projected service, less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. Projected salaries should reflect an estimate of the future compensation levels of the individual employees involved, including future changes attributed to the general price level, productivity, seniority, promotion, and other factors.

72. The administrative entity should report a pension expense for the net of the following components:

- normal cost;
- interest on the pension liability during the period;
- prior (and past) service cost from plan amendments (or the initiation of a new plan) during the period, if any; and
- actuarial gains or losses during the period, if any.

The individual components should be disclosed.

73. The administrative entity should report revenue for the sum of amounts received from the employer entity representing contributions from:

- the employer entity and
- its employees.[35]

The employer entity's contribution represents intragovernmental revenue.[36]

An illustration of the accounting for the administrative entity (and the employer entity) is explained in the following section entitled "Accounting Illustration."

[35]The administrative entity may also receive financing from the General Fund to cover prior service or other cost for which contributions from employer entities are not provided.

[36]Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

Employer Entity Accounting

74. The federal employer entity should recognize a pension expense in its financial report that equals the service cost[37] for its employees for the accounting period, less the amount contributed by the employees, if any. The measurement of the service cost should require the use of the plan's actuarial cost method and assumptions, and therefore the factor to be applied by the employer entities must be provided by the plan and/or the administrative entity.

75. The employer entity's pension expense should be balanced by: (a) a decrease to its "fund balance with Treasury" for the amount of its contribution to the pension plan, if any; and if this does not equal the full expense, by (b) an increase to an account representing an intragovernmental imputed financing source entitled, for example, "imputed financing - expenses paid by other agencies." The latter represents the amount being financed directly through the pension plan's administrative entity.

76. In special instances when an employer entity is also the administrative entity, that is, when there is no separate pension plan (e.g., the Coast Guard), the employer entity should report the liability and recognize the pension expense for all components of cost. The liability and the expense should be accounted for as described in the preceding section for the administrative entity without reference to transactions with external employer entities.

Accounting Illustration

77. Tables 1-4 provide an example in which the employer entity recognizes an "employer's pension expense" in an amount equal to the service cost attributable to its employees during the accounting period, less the employees' own contributions. The expense in this example is more than the contribution that the employer entity is required by law to pay. The difference between the employer's pension expense and the employer's contribution is credited to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The employer entity transfers its contribution and that of its employees to the administrative entity.

78. The administrative entity recognizes revenue for: (1) contributions from the employer entity, (2) contributions from the employees, and (3) interest on the plan's investments. The administrative entity recognizes expense for the net of the pension cost components.

    Assumptions are as follows:

    - Total normal cost of employees for the accounting period is $160,000.
    - The employer's pension expense is $100,000. The employer entity would calculate its pension expense on the basis of information received from the plan and/or the

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[37] "Service cost" is defined as the actuarial present value of benefits attributed by the pension plan's benefit formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost."

administrative entity. Its pension expense is equal to its share of the service cost of its employees' pensions.

- According to current law, the employer entity is authorized in its appropriation to pay $60,000 for employee pensions.
- The employees contribute $60,000 to the pension fund.
- No general fund appropriations made directly to the administrative agency are involved in these transactions, as they could be under actual operations.

Entry #1 -- Employer entity's entry to record pension expense:

	Debit	Credit
Employer's Pension Expense	$100,000	
Appropriations Used		$60,000
Imputed Financing - Expenses Paid by Other Entities		$40,000

Table 1

Employer Entity's Other Financing Sources as They Should Appear on Its Statement of Changes in Net Position

FINANCING SOURCES:[38]

Appropriations Used	$60,000
Imputed financing	$40,000

Note: Imputed financing covers the difference between (1) the employer entity's contribution transferred to the administrative entity pursuant to law (exclusive of the employees' contributions) and (2) the employer's pension expense calculated on the basis of information received from the administrative entity--as shown immediately below.

Employer Entity's Cost as It Should Appear on the Statement of Net Cost

COST :

Employer's pension cost	$100,000

Note: This is the employer entity's service cost of employee pensions. The employer entity would calculate this amount using factors provided by the plan and/or the administrative entity. Also to be transferred to the administrative entity is the amount withheld from employees' wages, as called for under the terms of the plan. The employees' contribution is not an expense of the employer entity.

Note: The above table and those that follow in the sections on pensions and ORB are presented for illustrative purposes only; the responsibility for defining the form and

[38]SFFAC No. 2, *Entity and Display*, presents a change in the way revenue and other financing sources are reported. This illustration reflects the new concepts.

content of a financial statement prepared pursuant to the Chief Financial Officers Act, as amended, is the responsibility of the Office of Management and Budget.

Entry #2 -- Administrative entity's entry to record revenue received from employer entity:

	Debit	Credit
Fund Balance with Treasury	$120,000	
Retirement Program Revenue - Contribution Received from Employer Entity		$60,000
Retirement Program Revenue - Contribution Received from Employees		$60,000

Entry #3 -- Administrative entity's entry to record revenue from interest on investments in Treasury securities:

	Debit	Credit
Fund Balance with Treasury	$XXX,XXX	
Interest Revenue		$XXX,XXX

Table 2

Administrative Entity's Revenue as It Should Appear on the Statement of Net Cost

LESS OTHER EARNED REVENUES:	
Contributions received from employer entities	$60,000
Contributions received from employees	60,000
Interest on investments.................................	XX,XXX
Total other earned revenues	$ XXX,XXX

Note: Contributions are amounts transferred to the administrative entity from the employer entity representing its contribution--and that of its employees--for the employees' pensions.

Entry # 4 -- Administrative entity's entry to record its pension expense:

	Debit	Credit
Pension Expense	$XXX,XXX	
Pension Liability		$XXX,XXX

Table 3

Administrative Entity's Pension Expense

Normal cost	$160,000
Interest on pension liability	XXX
Prior serv. costs (gains) (if any)	XXX
Actuarial gains (losses) (if any)	XXX
Total pension expense	$ XXX,XXX

Note: The $160,000 represents 100 percent of the normal cost—as calculated by plan actuaries—for the one employer entity in this example. According to law, $60,000 of this amount is to be contributed by the employer entity and $60,000 is to be contributed by the employees themselves. The remaining $40,000 is a liability of the pension plan (covered by future financing sources). The pension expense is reported on the Statement of Net Cost in accordance with paragraph 72.

Table 4

Administrative Entity's Pension Liability:

Beginning balance	$ XX,XXX,XXX
Add: additional pension expense incurred (as calculated in table 3)	XXX,XXX
Less: payments made to beneficiaries	XXX,XXX
Ending liability balance	$ XX,XXX,XXX

Note: The liability balance should be reported on the administrative entity's Balance Sheet.

Other Retirement Benefits (ORB)

79. ORB include all retirement benefits other than pension plan benefits.[39] ORB are provided outside the pension plan by an employer to a former employee or the employee's beneficiary upon retirement. The predominant ORB in the federal government is retirement health care benefits, and they are the focus of this section.[40]

80. Future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare (part A). Also, medical plans do not vest like pensions in which, after a fixed number of years of service, an employee has a right to receive payment. To receive ORB benefits the employee must retire with health care benefits provided by the organization.

81. This Statement establishes standards of accounting for ORB expense and related ORB liability for federal government employers and administrative agencies.

Accounting for the ORB Plan

82. **Attribution Method**—The aggregate entry age normal actuarial cost method should be used to calculate the ORB expense and liability for the administrative entity's financial statements, and the expense for the employer entity's financial statements. As indicated in the pension section, aggregate entry age normal is a method under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages. It should be applied to ORB on the basis of service rendered by each employee. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion not provided for at a valuation date by the actuarial present value of future normal cost contributions is called the actuarial accrued liability.[41] Unlike federal pensions, retiree health care benefits do not depend on future salary levels of individual employees but rather are allocable to each employee on a per person basis. Plans may use other actuarial cost methods if they explain why aggregate entry age normal is not used and if the results are not materially different.

[39]See Appendix A: Basis for Conclusions, for a discussion of reporting medical costs for veterans.

[40]Accounting for life insurance is described in a separate section of the liability standard. However, to the extent that premiums paid by covered individuals and employer entities do not fully cover the retirement life insurance cost of employees, the employer entities would account for the additional cost as described in this section.

[41]Adapted from Actuarial Standards of Practice No. 4, p. 31. Also see Actuarial Standard of Practice No. 6, *Measuring and Allocating Actuarial Present Values of Retiree Health Care and Death Benefits*, Actuarial Standards Board (1988).

83. **Assumptions**—Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for federal employee pensions and (2) a long-term health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The discount rate assumption for present value measurements of ORB liabilities should be developed in accordance with paragraph 66 of this standard. The administrative entity should disclose the assumptions used.

84. **The accrual period** should be based on expected retirement age rather than the age when the employee first becomes eligible.

85. **Assets** should be reported separately from the ORB liability rather than merely reporting the net liability. Assets of federal ORB plans should be carried at their acquisition cost, adjusted for amortization, if appropriate.[42] For investments in market-based and marketable securities, the market value of the investment should be disclosed.

86. **Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses**—The standard for ORB is the same as that for pensions. Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior service resulting in a gain to the plan to the extent that previously recognized benefits are reduced. The accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the ORB liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

87. The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.

88. **Accounting by the Administrative Entity**—The ORB plan should be accounted for in a way that is very similar to that described above for pensions. The administrative entity should account for and report the ORB liability in its financial report, using the aggregate entry age normal method. The liability is the actuarial present value of all future benefits less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. The administrative entity should report an ORB expense for the net of the following components:

- normal cost,

[42]See SFFAS No. 1, *Accounting for Selected Assets and Liabilities*.

- interest on the ORB liability during the period,
- prior (and past) service costs from plan amendments (or the initiation of a new plan) during the period, if any,
- any gains/losses due to a change in the medical inflation rate assumption; and
- other actuarial gains or losses during the period, if any.

The individual components should be disclosed.

89. The administrative entity should report revenue for the sum of amounts received, if any, from the employer entity representing contributions from:

- the employer entity and
- its employees.

The employer entity's contribution represents intragovernmental revenue.[43] An illustration of the accounting for the administrative entity (and employer entity) is provided in the following section entitled "Accounting Illustration".

Employer Entity Accounting

90. The federal employer entity should account for and report the ORB expense in its financial report in a manner similar to that used for pensions. The employer's ORB expense should be recognized in an amount equal to the total service cost[44] for its employees for the accounting period, less the amount contributed by its employees, if any. The measurement of the service cost requires use of the plan's actuarial cost method and assumptions. The cost factor should be provided to the agencies on a per employee basis by the administrative entity and/or the plan.

91. The employer entity's ORB expense should be balanced by (a) a decrease to the employer entity's "fund balance with Treasury" for the amount of its contributions to the ORB plan, if any; and, if this does not equal the full expense, (b) by an increase to an account representing an intragovernmental financing source entitled, for example, "imputed financing - expenses paid by other entities." The latter represents the amount being financed directly through the ORB plan.

[43]Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

[44]"Service cost" is defined as the actuarial present value of benefits attributed to services rendered by employees during an accounting period. The term is synonymous with "normal cost".

92. In special instances when an employer entity is also the administrative entity, the employer entity should report the liability and recognize the ORB expense for all components of cost. For example, the entity is paying its retirees' ORB on a pay-as-you-go basis. The liability and the expense should be accounted for as described in the preceding section for the administrative entity accounting without reference to transactions with external employer entities.

Accounting Illustration

93. Tables 5-8 provide an example where the employer entity recognizes an "employer's ORB expense" in an amount equal to the service cost attributable to its employees during the accounting period. In this example, neither the employer entity nor its employees contribute to the plan. The employer's ORB expense is offset by a credit to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The administrative entity recognizes a revenue and other financing source for contributions from the General Fund. The administrative entity recognizes an expense for the total ORB expense.

Assumptions are as follows:

- Total normal cost of employees for the accounting period is $10,000.[45]
- The employer's ORB expense is $10,000. The employer entity should calculate its expense on the basis of factors received from the plan and/or the administering entity. For example, the plan-supplied factor is $100 per employee (or full-time equivalent); if the employer has 100 employees, the expense would be $10,000. (The employer's ORB expense equals the service cost of its employees' retirement health care.)
- The employer and employees do not make contributions to a fund. The cost of retirement health care is paid for by General Fund appropriations directly to the administrative entity on a pay-as-you-go basis.

Entry #5 -- Employer entity's entry to record ORB expense:

	Debit	Credit
Employer's ORB Expense	$10,000	
Imputed Financing-Expenses Paid by Other Entities		$10,000

[45]This is the amount attributable to the government for its share of future medical care costs for future retirees. Although this simplified illustration does not show contributions other than those from the General Fund, current retirees pay premiums for their health insurance that partially defray the cost of the program. Federal civilian retirees pay approximately 25-30 percent of the total health benefit premium.

Table 5

Employer Entity's Other Financing Sources as They Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:
Imputed financing Expenses paid by other entities ... $10,000

Note: Imputed financing "Expenses paid by other entities" covers the annual expense for the employer entity's employees as shown immediately below.

Employer Entity's Cost as It Should Appear on the Statement of Net Cost

COST :
Employer's ORB cost $10,000

Note: This is the annual ORB service cost of the employer entity's employees. The employer entity would calculate this amount using factors provided by the administrative entity.

Table 6

Administrative Entity's Other Financing Sources as It Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:

Appropriations used......... $ XX,XXX

Note: Since, in this example, contributions are not required from the employer entity or its employees, all benefits must be paid with appropriations from the General Fund.

Entry #6 -- Administrative entity's entry to record its ORB expense.

	Debit	Credit
ORB Expense	$XX,XXX	
ORB Liability		$XX,XXX

Table 7

Administrative Entity's ORB Expense

Normal cost	$ 10,000
Interest on ORB liability	XX,XXX
Prior service costs (gains) (if any)	XX
Actuarial gains (losses) (if any)	XX
Total ORB expense	$ XX,XXX

Note: The $10,000 represents 100% of the service cost attributable to the employer entity in this example, as calculated by plan actuaries. The ORB expense (as calculated above) would be reported on the Statement of Net Cost in accordance with paragraph 88.

Table 8

Administrative Entity's ORB Liability

Beginning balance	$ X,XXX,XXX
Add: additional ORB expense incurred (as calculated in table 7)	XX,XXX
Less: payments made on behalf of beneficiaries	XX,XXX
Ending liability balance	$ X,XXX,XXX

Note: The liability balance should be reported on the administrative entity's Balance Sheet.

Other Postemployment Benefits (OPEB)

94. OPEB are provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans. Inactive employees are those who are not currently rendering services to the employer but who have not been terminated, including those temporarily laid off or disabled. Postemployment benefits can include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment, workers' compensation, and veterans' disability compensation benefits paid by the employer entity.

95. The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events

occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the interest rate on marketable Treasury securities of similar maturity to the period over which the payments are to be made. The discount rate assumption for present value measurements of OPEB liabilities should be developed in accordance with paragraph 66 of this standard.

96. Most OPEB liabilities should be short-term because the benefits will be paid in the near future. Some OPEB, however, could be longer term. For example, a liability for workers' compensation or veterans' disability compensation might be long-term for some injuries since federal employer entities might be required to reimburse the program for many years.[46] Also, certain specially authorized separation incentive programs could provide for payments that extend over many future years.

Insurance And Guarantees

[Paragraphs 97-121 rescinded by SFFAS 51.[47-54]]

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

[46]Both the federal employee unemployment program and the federal workers' compensation program are financed by direct reimbursements from federal employers.

[47-54]Footnotes rescinded by SFFAS 51, *Insurance Programs*.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

122. This appendix summarizes considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

123. This Statement addresses recognition and measurement of liabilities in the general purpose financial reports of federal reporting entities. The unique circumstances of the federal government, most notably its role as the vehicle through which citizens express their sovereign power, meant that the Board had to resolve some new issues in order to define exactly how to apply accrual concepts in federal financial reports.

124. The Board's deliberations on liabilities were based on certain ideas about the distinction between exchange and nonexchange transactions, the importance of reporting cost of services provided by the federal government, and the impact of information on decisionmakers. These ideas are explained in the following paragraphs.

125. Many users of federal financial reports are familiar with accounting concepts and standards published by the Financial Accounting Standards Board (FASB) for private sector entities, and the Governmental Accounting Standards Board (GASB) for state and local government entities. Because such users might assume that identical concepts and standards are used by the federal government if differences are not explained clearly, this appendix compares certain concepts underlying the federal standard with concepts that govern recognition and measurement of liabilities in financial reports of private sector entities and state and local governments in the United States. Finally, this appendix also explains the basis for specific conclusions regarding social insurance, contingencies, federal employee pensions, other retirement benefits, other postemployment benefits, and insurance and guarantee programs.

Exchange And Nonexchange Transactions

126. As noted in SFFAC No. 1, *Objectives of Federal Financial Reporting*: "The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or

promises to provide them."[55] In some transactions, consideration of value is exchanged: there is a reciprocal or two-way flow. Other transactions, such as grants and other transfer payments are nonexchange transactions (i.e., there is a nonreciprocal transaction--normally a one-way flow).

127. The federal government is the vehicle through which citizens of the nation exercise their sovereign power. In this role, the federal government is responsible for taking collective action at the national level "to promote the general welfare." Thus the government undertakes many programs that do not involve reciprocal transfers between the government as an entity and its counterparties. Examples include disaster relief, grants to state and local governments, subsidies, and other transfer programs for individuals. The federal government has a propensity to assume such burdens because it is the agent by which the society, through its elected officials, accomplishes transfers between groups of citizens to enhance their well-being.

128. A taxpayer or a donor may, in fact, receive a benefit of some sort, such as the opportunity to live in a safe, secure environment; to improve one's standard of living; and to receive specific benefits, such as visits to national parks and travel over highways. But it is not ordinarily said that the benefit to the individual taxpayer or donor is of value comparable to that of the consideration given. Therefore, these are classified as nonexchange transactions. For this Statement, the significance of the distinction between exchange and nonexchange transactions arises from the nature of the obligation that is created when one party to a transaction provides a product or service to the other party in return for a promise that something of value will be exchanged for it.

129. Obligations become legally enforceable claims against the federal government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing between various programs is whether an exchange is involved. For example, the federal government may not contract for and receive goods or services and then arbitrarily decide not to honor the contract. Similarly, under existing law, the federal government may be financially responsible for certain damage and injury it causes.

130. In other cases, the obligation may be more a matter of what is perceived as equitable and good public policy than a legally enforceable claim. Although there may be a high probability that a grant, a subsidy, or an income transfer will be made or will continue in future years, the recipients of such grants, subsidies, or transfers do not have a right to receive such payments in the future from the federal government as do those who receive payments in exchange for service they have performed.

[55] SFFAC No. 1, paragraph (16c).

131. However, it is possible to make meaningful estimates of the future amounts required to continue present policies regarding such programs. These estimates are relevant to certain decisions and should be disclosed or otherwise reported, as discussed further in *Supplementary Stewardship Reporting*. 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.

132. In the case of federal liabilities, some future outflows of resources are so likely that they should be recognized as accounting liabilities in general purpose federal financial reports before all the other events necessary to create a legally enforceable claim against the government exists.[56] Two important examples of such substantive accounting liabilities are the pensions and retirement health care promised federal workers in return for their service.

133. An exchange can in substance be said to have occurred in such cases, even if the government has not yet made an outlay of cash or other financial resources. Service has been exchanged for a promise of future payment or health care. Such charges are properly assignable to the current period in financial reports. This exchange implies, for example, that general purpose federal financial reports should recognize the financial effects of the promise to provide health care to retired federal workers as that obligation accrues during their years of service, regardless of whether the budget includes a provision for this item. This is true even though unfunded liabilities of the federal government reported on the financial statements cannot be liquidated without the enactment of an appropriation. Also, as a sovereign entity, the payment of all liabilities other than for contracts can be abrogated by the federal government.

Conclusion On Social Insurance

134. The recognition, measurement and display of obligations for social insurance programs presented the Board with significant theoretical and practical problems. From the theoretical perspective, the Board considered whether social insurance programs resulted in exchange or nonexchange transactions, or whether they contained both exchange and nonexchange features. The Board also considered the problems of articulation between the operating statement and the Balance Sheet, specifically whether the process of reporting a year-to-year change in a Balance Sheet liability might affect the usefulness of an operating statement measure of performance. Finally, the Board considered the difficulty of

[56] Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress.

determining an appropriate measure of the obligation assumed, whether such a measure were to be presented on the face of the Balance Sheet or in the notes.

135. In the exposure draft *Accounting for Liabilities of the Federal Government*, the majority of the Board concluded that social insurance programs were entitlement programs developed to carry out the sovereign responsibilities of the government, financed primarily by compulsory earmarked taxes. The Board favored characterizing social insurance obligations as nonexchange transactions, and limiting recognition of a liability to any unpaid amounts due as of the reporting date. A significant majority of the respondents, however, agreed with an alternative view, which expressed the notion that social insurance programs contained both exchange and nonexchange features, and that there was a need for recognizing a liability at least equal to the present value of future payments due to recipients currently eligible for benefits.

136. Upon reconsideration of the issues, the Board concluded that the most appropriate approach from both the Balance Sheet and Statement of Net Cost perspectives would be: (1) to include a line item entitled “social insurance obligations” in a separate section of the Balance Sheet following the liability section and before the equity section; (2) to make note disclosure of supplementary data resulting from several approaches for measuring the obligation, and (3) to report the annual financial outflows of current financial resources on the Statement of Net Cost. The Board also decided that, given the sensitivity and magnitude of social insurance, this new position should receive additional exposure, to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and consolidated in Supplementary Stewardship Reporting.

Impact Of Communicating Information In General Purpose Federal Financial Reports

137. FASAB recognizes that extensive information about probable and possible future federal outlays is available now in many special purpose reports on various federal programs. In that sense, the financial reports prepared pursuant to this Statement are not likely to reveal information that is new in an absolute sense. Analysts working for the various executive agencies, congressional committees, private interest groups, “think tanks” and universities are, collectively, aware of this information and much more. Nevertheless, the Board believes that presenting liabilities and stewardship responsibilities in the general purpose federal financial reports can be valuable in several ways. There are at least four reasons for this belief.

138. First, analysts typically know a lot about certain programs, but only those programs. Currently it is difficult, if not impossible, to assemble comprehensive information prepared on a comparable basis for the federal government as a whole. In many cases, this is also true for significant component units. General purpose federal financial reports attempt to provide a way of presenting comprehensive information.

139. Second, much of this information has no impact on individual decisionmakers, such as program managers, unless it is conveyed in a way that facilitates, or even requires, suitable attention to it. For example, information about federal pension plans and retirement benefits conveyed in an actuarial report or in the narrative section of the *Budget of the United States Government* may have an impact on certain congressional decisions, but is unlikely to influence managers' decisions about whether to use federal employees, invest in labor-saving equipment, or contract out to accomplish a given task. If the information is to have such an impact, it must be reported in a way more directly associated with the activities the manager is responsible for. Associating the expenses and liabilities reported in the general purpose federal financial report with the outputs of responsibility centers is able to accomplish this direct association.

140. Third, the mere requirement to assemble and report these data will, in some cases, affect federal managers, who, like everyone, tend to manage what they measure. Some observers believe, for example, that the prospect of having to comply with FASB's Statement 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, caused corporate managers and others to focus increased attention on the need to manage the cost of promises they had made to provide health care to retirees, even before the statement became effective.

141. Fourth, financial reports prepared and audited pursuant to federal accounting standards may reasonably be expected to possess a certain credibility and to command a certain amount of attention from various users, sufficient to affect decisions about federal government public policy. They will provide a source of information that should complement what is provided by the *Budget of the United States Government*. An important collateral benefit arises from the processes of preparing, auditing, and publishing annual financial statements. Experience demonstrates that these processes improve the reliability of information and of control systems, thereby enhancing both decisionmaking and accountability in general.

Relationship To Liability Recognition Principles Used By Nonfederal Entities

142. FASB defines the basic principles that govern liability recognition by private sector entities in the United States.[57] Government corporations follow those standards in their separately issued financial statements. Probably most readers of this Statement are familiar with these principles. Probably most users of federal financial reports are accustomed to seeing other financial reports prepared according to these principles.

143. FASAB's principle for liability recognition differs from FASB's. The difference can be seen as a modification made necessary by the sovereign nature of the federal government. FASAB contemplates a liability standard within the context of a reporting model that provides much greater emphasis on publicly reporting certain stewardship responsibilities than does the reporting model used by private sector organizations. This kind of reporting model is necessary because of the federal government's responsibility for the general welfare of the nation and its resulting willingness to take on obligations.

Conclusion On Contingencies

144. In the Exposure Draft the Board asked the following question. "When an estimated [contingent] liability is a range of amounts and no amount within the range is a better estimate than any other amount, should either the midpoint or, alternatively, the 'expected value' (as the term is used in statistics) be recognized as a liability instead of the minimum amount?" The majority of respondents preferred the expected value and the second preference was the minimum amount.

145. The Board further considered all of the options. Based on the Board discussions it was noted that it would be difficult to use "expected value" to pinpoint an estimate within a range. The expected value method would assign a probability percentage to each of the numbers within the range, but these probabilities would usually be difficult to estimate.

146. After much discussion the majority of the Board preferred the minimum amount because of its established use in other accounting standards. The Board decided that liabilities arising from nonexchange transactions would be recognized for any unpaid amounts due as of the reporting date. This includes amounts payable from the federal entity to pay for benefits,

[57]The Governmental Accounting Standards Board (GASB) has not published a concept statement on financial statement elements as FASB has done in Concept Statement Number 6 and has not defined "liability" per se. In the current state and local governmental accounting model, a fund liability is "the amount left unpaid at the end of the reporting period that normally would be liquidated with expendable available financial resources. The remainder of the liability should be reported in the General Long-Term Debt Account Group (GLTDAG)." National Council on Government Accounting Statement (NCGAS) Number 4, par. 17. (See GASB *Codification of Governmental Accounting and Financial Reporting Standards*, section 1500.)

goods, or services[58] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers that will be financed by the federal entity but have not yet been reported to the federal entity).

147. In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions a liability would then be recognized at the point the amount is due. Therefore, government-acknowledged events do not meet the recognition criteria necessary to be recognized as a contingent liability. The government is acting in its sovereign capacity when it assumes financial responsibility and makes income transfer payments or provides other nonexchange benefits. The Board does not believe that accounting recognition should anticipate sovereign actions in advance of occurrence.

Conclusion On Pensions, Other Retirement Benefits And Other Postemployment Benefits

Pensions - Projected Salary Levels

148. A primary objective for federal financial reporting is to measure accurately the full cost of employer entity services to the public. The methods used to account for pensions, ORB, and OPEB in general purpose financial reports should accurately measure the full cost of an employer entity's services. Since federal pension benefits are based on final salaries, whatever method is used for the annual cost and accrued liability of federal pensions must include projected future salaries that reflect an estimate of the compensation levels of the individual employees involved (including future changes attributable to the general price level, seniority, promotion, and other factors). They are part of the obligation that the federal government is incurring.

[58]Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of disaster relief beneficiaries.

Accounting For The Pension Plan

Attribution Methods

149. The major federal pension plans use an actuarial cost method for funding purposes known as aggregate entry age normal (AEAN). Various actuarial cost methods exist. All the methods regarded as acceptable methods for advance funding of private pension plans recognize the cost of an employee's pension benefits during the employee's years of service, but the different actuarial methods recognize the cost in different patterns over time. The AEAN method is intended to produce a periodic pension cost that is a level percent of payroll.

150. That is, AEAN is a method under which the present value of projected benefits of each employee is allocated on a level basis (such as a constant percentage of salary) over the service of the employee between entry age and assumed exit age. The portion of this present value allocated to each 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.

151. FASAB considered the method used by the Financial Accounting Standards Board in Statement of Financial Accounting Standards (SFAS) No. 87, *Employer Accounting for Pensions* (the projected unit credit, or PUC), as well as AEAN. FASB concluded that PUC gave a better measure of the employer's obligation for the benefits earned by the employees at a particular point in time. It therefore said that PUC provides a better measure of the value of the benefits that accrue during the year. However, FASAB heard testimony from an OPM actuary that results from these two methods were similar for federal plans. FASAB concluded that AEAN is a sound measure of the accruing expense.

152. FASAB concluded that any method of assigning the value of benefits that are earned over the entire career to particular years of service involves a process of estimation. It is, of course, reasonable to assume that the benefits accrue in some sort of systematic and uniform fashion and not, for example, all at once when the employee becomes eligible. Assuming that the benefits accrue as a uniform percentage of salary each year (as is done with AEAN for pensions) is a reasonable approach. AEAN is particularly useful within an organization when measuring costs over time because it provides that a dollar of salary always equals a fixed percent of pension, regardless of the year involved. Thus, inflation is factored into the calculation automatically.

153. FASAB specified the AEAN for several reasons. First, as stated, AEAN is a reasonable and systematic way of allocating costs evenly over the service lives of employees. Second, the major federal retirement systems [the Military Retirement System (MRS), the Civil Service Retirement System (CSRS), and the Federal Employees Retirement System (FERS)] use

AEAN, and in two cases (FERS and MRS) charge "full cost" in the budget under a statutory requirement.[59] Finally, exact comparability with private-sector entities is not relevant. Minor differences in the size of the pension liability and expense calculated pursuant to this Statement and SFAS 87 clearly would not have a material impact on investor's assessment of the credit-worthiness of the U. S. government.

154. Since there are several acceptable attribution methods and several small pension plans in addition to the three major plans, FASAB decided that the use of methods other than AEAN was permitted provided the results were not materially different from those of AEAN. A material difference between the expenses and the liabilities for federal plans based solely on the choice of attribution method would destroy the comparability and impair the usefulness of the information for users other than investors.

155. FASAB recognizes also that other attribution methods might be useful for other purposes. For example, a method that calculates the vested benefits accrued by employees to date, at current salary levels, would be useful as a measure of the accumulated amount the plan would owe if it were to terminate. Such calculations would be for special purpose reports not covered by this Statement.

Assumptions

156. There are three objectives for actuarial assumptions. First, FASAB considers it extremely useful to have consistent assumptions among accounting, budgeting, and actuarial statements to the extent it is possible to do so while attaining the objectives of federal financial reporting.

157. Second, assumptions ought to be consistent across federal employee pension, other retirement benefit, and other postemployment benefit systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of reasonable estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.

[59]The CSRS statute calls for procedures that are generally construed as entry age normal. "Full cost," of course, depends on the method selected. For example, prior service cost is amortized in FERS over 30 years pursuant to the funding method; it would be recognized over a shorter period (years of expected future service of the group or 15 years) under SFAS 87. It should be recognized in full immediately under the terms of this standard, but only in financial reports of the agency that administers the pension plan and in the consolidated financial statements of the United States, not in the employer agency's financial statements. Thus, "full cost" in this sentence must be read in a generic way, that is, as a statement of the general intent underlying the law.

158. Third, assumptions ought to reflect the underlying economic substance of the transaction. They should reflect the entity's past experience and current expectations regarding cost trends. They should reflect the similarities of and differences between two sets of economic phenomena rather than forcing artificial uniformity.

159. FASAB concluded also that the discount rate should reflect the long-term expected return on plan assets rather than a current market rate on debt of comparable maturity (the discount rate called for by SFAS 87). The long-term expected rate reduces volatility, reflects the actual experience and expectations of the primary federal plans, and is consistent with the assumptions used in the budget. The Governmental Accounting Standards Board uses a similar approach for the discount rate for state and local government pensions for similar reasons.

Prior Service Cost

160. Prior service costs (or gains) are the costs (or gains) of retroactive benefits granted (or reduced) in a plan amendment. Under the current budgetary system, prior service costs are funded in the budget through General Fund appropriations over 30 years. The employer entities under MRS and FERS--which are intended to be fully funded--are not charged in their budgets for prior service cost (nor are they credited for gains), but rather the General Fund is charged for these costs.[60]

161. As stated in the Statement, FASAB believes that prior service costs, interest on the pension (or ORB) liability, and actuarial gains and losses are expenses of the federal government as a whole and are best accounted for by the administrative entity. Some respondents did not agree that employer entities should recognize only the "normal" or "service" cost element. The respondents suggested that the employer entity should recognize all elements of the pension (or ORB) expense: service costs, prior service costs, actuarial gains and losses, and interest on the pension liability. In general, these respondents believe that the full cost of products and services produced by the employer entity includes these elements, and that the full cost thus defined is relevant to various decisions such as comparing the cost of outputs and services with alternative providers.

162. The Board considered these views, but it continues to believe that employer component entities of the U. S. Government should usually recognize only the service cost element of pension (and ORB) expense in their general purpose financial reports. (Exceptions will arise in cases such as the Coast Guard, where the employer entity is also the administrative

[60]CSRS also receives General Fund appropriations for this purpose, but the appropriations are based on statutory provisions and are less than they would be under a fully funded approach. Because of this, the CSRS funding approach is not being used as an example of budgetary treatment to be contrasted with the accounting treatment.

entity for the plan). The Board is aware that its approach may appear to differ from the approaches taken by FASB and GASB in this regard. However, neither of those Boards focused, in their standards on pensions and other retirement benefits, on reporting by component entities of a larger reporting entity comparable to the Government of the United States. All elements of pension (and ORB) expense should be recognized in the consolidated financial statements of the United States Government; however, the Board believes that prior service cost and other non-service cost are not useful for most managerial or policy decisions at the program level. They are sunk costs (or sunk gains) attributable to services rendered in prior years, or otherwise are not under the control of program management. FASAB continues to believe that having non-service elements of cost reported by the administrative entity best reflects the federal environment and organizational structure.

163. The Board recognizes that some analysts might, for some purposes, want to consider an alternative measure of compensation cost, e.g., one that includes interest on the part of the pension (or ORB) liability that relates to current workers, or one that recognizes some non-service costs over the workers' years of expected service. Special analyses and reports will always be necessary for special purposes. General purpose financial reports must, by definition, focus on the most common needs of users of those reports.

164. For similar reasons, FASAB also continues to believe that prior service costs (or gains) should be recognized immediately, without amortization, by the administrative entity, and in federal government-wide financial reports. FASAB sees no benefit to delaying recognition of a cost and a liability or to reducing volatility in the general purpose financial report of the administrative entity. FASAB was not persuaded that the benefit (or the cost) derived in future periods from increased (or deceased) pension benefits was sufficiently tangible in the federal context to warrant delayed recognition by means of amortization over future periods. Examples of plausible future benefits or costs would be, increased (decreased) employee productivity or reduced (increased) turnover.

165. FASAB recognizes that, for funding purposes, prior service costs for CSRS, FERS, and MRS are amortized through appropriations over a number of years. Funding decisions, however, should not be determinative for accounting recognition of cost. Deciding when and how to fund an obligation is not an accounting issue.

Actuarial Gains and Losses

166. Actuarial gains and losses result from (1) deviations between actual experience and the actuarial assumptions used and (2) changes in actuarial assumptions. Actuarial assumptions are essentially long-range estimates about future events and necessarily vary from actual experience.

167. Actuarial gains and losses and prior service costs (or gains) have similar characteristics. They are both determined after the accounting period in question has concluded, and both relate to the past (either prior service or prior experience). The difference between actuarial

gains and losses and prior service costs (or gains) is that the former are the normal result of actuarial estimation and may occur annually, while prior service costs are incurred only when the plan is amended. Also, actuarial gains and losses may tend to even out over time, unlike prior service costs.

168. FASAB concluded that actuarial gains and losses should receive the same treatment as prior service costs (or gains). They should be charged to the administrative entity. The employer entities should recognize an expense only for the service cost[61] of their employees for the period less the amount contributed by the employees, if any. Like prior service costs, the actuarial losses are sunk costs (or sunk gains) attributable to services rendered in prior years and therefore should be excluded from data used for managerial or policy decisions.

169. For the same reasons as were given for prior service costs, actuarial gains and losses should be recognized immediately by the administrative entity. There is no benefit in delaying recognition or reducing volatility in the cost measures and the financial reports of the administrative entity.

Recognition and Measurement

170. The Board's conclusions discussed immediately above are reflected in the accounting treatment of pensions. The employer entity should recognize an annual pension expense as a cost of operations. When the employer entity's contributions are less than its pension expense, the employer entity should recognize an imputed financing source for the expenses paid by other entities. To the extent that it receives contributions from the employer entity, the administrative entity should recognize an intragovernmental revenue.

171. These transactions are intragovernmental. For purposes of federal government-wide consolidated financial reports, the employer's pension expense should be offset against (1) the administrative entity's contributions received from employer entities and (2) the employer entity's imputed financing source, if applicable.

172. The administrative entity should report the pension liability. An increase in the liability during the accounting period is an expense to the administrative entity. The liability is increased by the net total of the pension cost components [normal cost, interest on the pension obligation, prior service costs (gains), and actuarial gains (losses)]. Thus, the administrative entity should be providing information not only about the actuarial liability but also about the relationship between the full cost and the revenue from employees, employer entities, interest, and Treasury contributions.

[61]"Service cost" is defined as the actuarial present value of benefits attributed by the plan's benefits formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost".

173. Recognizing the pension cost components in the administrative entity and also the normal cost in the employer entities accomplishes two objectives. First, the full cost and actuarial liability are summarized and presented in one place, i.e., in the administrative entity's operating results and Balance Sheet. Second, each employer entity reports its respective normal cost as a cost of providing service. This is essential to report properly the cost of delivering federal government services. These entries are eliminated during consolidation for federal government-wide financial statements and, thus, no double counting occurs.

Other Retirement Benefits

174. FASAB concluded that ORB are similar to pension benefits and should be accounted for in a similar way unless differences in substance dictate otherwise. The predominant other retirement benefit in the federal government is health care benefits for retirees. These are long-term and require actuarial estimation.

175. FASAB recognizes that future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare.

176. Also, some federal retiree health benefits are provided directly in federal government hospitals and domiciliary facilities. The liability in these cases also depends on the amount that the Congress will appropriate in the future to pay for the benefits, so the expense and liability are more difficult to measure. Notwithstanding the measurement difficulties, because of the importance of approximating the cost of services rendered at the time the service is rendered, FASAB believes that in most cases, the ORB costs and liabilities should be measured for federal programs. However, as noted in the discussion starting with paragraph 182, VA medical care cost would be recognized in the period medical care service is rendered.

Accounting For The Other Retirement Benefits Plan

Attribution Method

177. Unlike the situation regarding federal pension plans, there is no established attribution method for federal retirement medical care. Although there are current proposals to do so, the costs are not currently being funded.

178. For retirement health care, FASAB found no compelling reason to prefer an approach other than the aggregate entry age normal used for pensions. The employer's service cost however, should be calculated differently for health care than for pensions. For the pensions, costs are calculated as a percent of payroll, but retirement health care benefits

are paid for each individual retiree regardless of prior salary. Cost, therefore, should be calculated on a per person basis because that accurately represents how the cost is incurred.

Assumptions

179. Although the general assumptions employed for ORB should be the same as those for pensions, the health care cost trend assumption is unique. The standard gives general guidance regarding the use of “Medicare projections or other authoritative sources” for the trend assumption in order to achieve consistency and set broad guidelines for the estimates. The health care cost assumption should reflect these sources adjusted for any factors unique to the organization.

Other Postemployment Benefits

180. OPEB represent operating expenses of the federal employer entity. Some might argue that OPEB, like pensions and ORB, should be accrued as employees perform services, as a cost of operations, because (1) they believe the event is occurring as the employees perform service, (2) future OPEB payments are probable, and (3) they can be measured. FASAB was not persuaded that there was an adequate nexus between these cost and the employee’s daily, ongoing service; or that these costs were sufficiently probable at that point to warrant accrual.

181. FASAB believes that an accrual based on the occurrence of an actual event, such as a job-related injury or a decision to reduce the entity’s workforce generally, is a reasonable approach. Such an event makes the future outflow of resources probable and measurable, may involve long-term accruals in some cases, and provides an accurate measure of expense in a way that is the least burdensome to the reporting entities.[62]

VA Medical Care Cost

182. Although it might appear that medical benefits provided by the Department of Veterans Affairs should be treated like other retirement or medical benefits, there are significant differences between the two. Most often retiree medical benefits are provided through a

[62]The federal workers’ compensation and unemployment insurance programs are different from the programs applicable to nonfederal workers. The benefits for federal employees under these programs are financed by direct reimbursement from employer entities. Usually the reimbursement period for workers’ and unemployment compensation is short-term, but under certain conditions, workers’ compensation may extend for many years.

health insurance provider, which receives premium payments from the former employer. But, with VA medical benefits, the former employer (the government) provides the medical services through VA facilities to veterans on an “as needed” and an “as available” basis versus payment of health insurance premiums for each veteran.

183. Eligibility for VA hospital care and nursing-home care is divided into mandatory and discretionary categories. VA must provide hospital care to veterans with service-connected disabilities and others in the mandatory category. Hospital care is considered discretionary if the veteran has income above a specified limit and a non-service-connected injury. Veterans in the discretionary category may be required to pay fees to receive VA hospital care. In addition, VA medical care is financed by annual appropriations. The entitlement to receive care does not guarantee any particular level of care. The Congress decides annually how adequately VA medical care will be funded.

184. The Board believes that VA medical benefits, for both mandatory and discretionary programs, are best measured by the annual cost incurred rather than by actuarially determined charges during the veteran’s military service. Medical care for veterans does not satisfy the probability or reasonably measurable criteria in this standard at earlier dates, and therefore future medical benefits do not constitute a long-term liability to be recognized in the Balance Sheet. The Board believes VA medical benefit liability and related expenses should be recognized in the period medical care service is rendered. The entity should consider, however, what disclosures would be appropriate for these costs under the contingency standard.

Conclusion On Insurance And Guarantees

185. The Board considered two possible bases for recognizing the liability of federal insurance programs. One would recognize as a liability the unpaid expected present value (PV) cost of insured events that had occurred. The second would recognize as a liability the unpaid expected PV cost of risks that had been assumed (i.e., the unpaid expected PV cost inherent in insurance extended or in force). This second approach would be similar to that taken by the Congress in budgeting for direct loans and loan guarantees and by FASAB in accounting for these transactions. (See Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*).

186. Several Board members believe that this second approach has merit from a conceptual standpoint. However, the Board has concerns about the measurability of the risk assumed, particularly in the context of pension guarantees. There may also be some question as to the exact nature or categorization of some assumed risks in the absence of written contracts. The Board concluded that it would continue the traditional practice of recognizing the effect of events that had occurred on the face of the financial statements. However, it

also decided to require reporting as RSSI the estimated PV cost of the risk assumed for all programs, except social insurance, life insurance, and loan guarantee programs.

187. Accrual accounting for insurance programs attempts to report the expenses of operations for each period and the unpaid liability at the end of the period. Projections of future claims, including renewed, expanded, and new business, also provide important information for policy decisions about what rates should be charged to cover all expected future losses, what additional insurance should be extended, and similar decisions. Management of reporting entities may wish to include such projections in financial reports as other accompanying information, and may do so on a voluntary basis, but the Board is not presently making any specific recommendations about this, beyond those required by this Statement and those to be further considered in *Supplementary Stewardship Reporting*.

188. During the Exposure Draft stage of the Liability Standard, the Board asked respondents whether the Standard provided sufficient guidance on how the risk assumed amount should be measured. Two of the fifty five respondents asked for additional guidance but did not mention measurement possibilities.

189. At the discussion stages of the final Statement the Board contemplated two possible measurement perspectives for reporting the risk assumed. The Statement requires that all federal insurance programs (except social insurance, life insurance, and loan guarantee programs) report the risk assumed amount as supplementary information. The risk assumed calculation as presented in the Exposure Draft measured the cost of the coverage outstanding during the reporting year. For annual term insurance programs, under this approach the risk assumed amount might not be significantly different from the sum of recognized liabilities and contingent liabilities reported on the Balance Sheet. However, the Board believes that requiring disclosure or supplementary reporting of a risk assumed number that is similar in concept and amount to the liability recognized could be confusing and would not add informational value.

190. In the second perspective, the risk assumed amount would be a broader and longer term measure of the government’s potential cost for on-going insurance programs. Under some measures, this second approach to risk assumed could be regarded as an indicator of the “fair” or “full cost” premium that should be charged if taxpayers are not to subsidize the program. This measure would be a probabilistic estimate of the expected cost under certain assumed economic factors. The Board found merits in this calculation, and believes it can provide important additional information beyond that contained in the accrual. Although they believe the measure to be important, proponents of this approach acknowledge that the measure may be difficult to measure precisely. Accordingly, they would treat it as RSSI. The Board currently has a project at the Exposure Draft stage, *Supplementary Stewardship Reporting*, that will provide further details on the measurement and reporting of “risk assumed” in its final statement.

191. The Board also considered the liability recognition of whole life insurance programs. The federal government has a small number of whole life insurance programs that are administered by federal entities. The most significant programs (mutual enterprise-type whole life insurance) are through the Department of Veteran Affairs (VA).

192. At the time the exposure draft on liabilities was issued, there were no established accounting standards for mutual enterprise-type whole life insurance within the federal government, state and local government, or the private sector. Therefore VA followed the statutory requirements for accounting purposes as well as statutory insurance reporting.

193. In January 1995, the FASB and AICPA issued a standard and a statement of position, respectively, that specified accounting for mutual whole life insurance enterprises. Due to the similarities between the federal programs and the insurance enterprises covered in the FASB and AICPA documents, the Board decided that the private sector standards would be appropriate for the applicable federal programs. Therefore the Board concluded that federal entities with whole life insurance programs would follow the standards as prescribed in the private sector standards (and as these private sector standards are amended) when reporting the liability for future policy benefits, along with the additional disclosures prescribed by this Statement. The Board further concluded that disclosure of the components of the liability was necessary to adequately inform the financial statement users of the projected use and any other potential uses of the liability components and associated assets.

Appendix B: Liability Recognition And Measurement Matrix

Federal Program Categories		Expense	Liability
General fund benefit programs—financed by general revenues	• Aid to Families with Dependent Children • Medicaid • Food Stamps • Special disabled coal miner benefits • VA pension[63]	Recognize expenses when payments are made or unpaid amounts are due as of the reporting date. This includes amounts due from the federal entity as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.	Recognize any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.
Employee benefits	• Federal employee pension and ORB benefits • Military pension and ORB benefits	Recognize expense as employee services are performed.	Recognize actuarial accrued liability.
	• VA disability compensation[64] • FECA—workers' compensation • OPEB	Recognize expense when relevant event occurs and program participant is determined eligible for compensation.	Recognize any amount due or the present value of future payments due, which ever is applicable.

[63]This program is an entitlement program that veterans may be eligible for if they have limited income when they have 90 days or more of active military service, at least one day of which was during a period of war. Their discharge from active duty must have been during a period of war. Their discharge from active duty must have been under conditions other than dishonorable. They must be permanently and totally disabled for reasons neither traceable to military service nor to willful misconduct. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

[64]Disability compensation is paid to veterans who are disabled by injury or disease incurred or aggravated during active military service in the line of duty. The service of the veterans must have been terminated through separation or discharge under conditions that were other than dishonorable. Monetary benefits are related to the residual effects of the injury or disease. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

Federal Program Categories		Expense	Liability
Insurance and guarantees	Fixed period—annual: • Federal Crop Insurance Corp. • National Flood Insurance Fund • Federal Deposit Insurance Corp. Fixed period—multi-year: • Overseas Investment • Noncancelable or renewable: • Pension Benefit Guaranty Corp.	Recognize an expense for claims of the period, including IBNR, i.e., insured events that occur.	Recognize liability for unpaid claims of the period, including IBNR, i.e., insured events that occur.
	Noncancelable or renewable: • Veterans Life Insurance Trust Fund • Employees' Life Insurance Fund	Recognize expense on the basis of risk assumed.	Recognize liability based on risk assumed (plus cash surrender value if relevant)
Capital leases		Recognize interest expense as lease payments are made.	Recognize a liability (the present value of future lease payments) when there is agreement between the federal government and the lessor.
Federal debt	• Treasury debt to federal agencies • Federal agency debt to the Treasury • Federal debt to the public	Recognize accrued (prorated) share of the nominal interest incurred during the accounting period, amortized discount or premium, and the amount of any change in current value for the accounting period for variable-value securities.	Recognize a liability at the par value of the security net of any unamortized discount or premium.

Appendix C: Glossary

See Consolidated Glossary in "Appendix E: Consolidated Glossary" on page 1.

Statement of Federal Financial Accounting Standards 6: Accounting for Property, Plant, and Equipment

Status

Issued	November 30, 1995
Effective Date	For periods beginning after September 30, 1997.
Affects	None.
Affected by	• SFFAS 10 rescinds paragraphs 27-28. • SFFAS 14 *(rescinded)* affects paragraphs 79-80, and 83-84. • SFFAS 16 *(rescinded)* amends paragraphs 59 and 60-63. • SFFAS 23 affects paragraphs 21 and 35 and rescinds paragraphs 46-56. • SFFAS 29 rescinds paragraphs 57-76 and amends paragraph 21. • SFFAS 32 amends paragraphs 45 and 107-111. • SFFAS 35 *(rescinded)* amends paragraphs 40 and 45. • SFFAS 42 rescinds paragraphs 77-84 and Appendix C. • SFFAS 50 amends paragraphs 25, 26, and 40. • SFFAS 59 transitionally amends paragraphs 25-26, 35, 40, 44-45 and inserts paragraphs 20A-20D, 34A, and 45A-45B. • TB 2006-1. • TB 2017-2. • SIG 6.1.
Related Guidance	• Interpretation 9, *Cleanup Cost Liabilities Involving Multiple Component Reporting Entities* • TR 2, *Determining Probable and Reasonable Estimate for Environmental Liabilities in the Federal Government* • TR 7, *Clarification of Standards Relating to the National Aeronautics and Space Administration's Space Exploration Equipment* • TR 10, *Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment* • TR 11, *Implementation Guidance on Cleanup Costs Associated with Equipment* • TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment* • TR 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant & Equipment* • TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* • TR 17, *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment* • TR 18, *Implementation Guidance for Establishing Opening Balances*

Summary

This statement contains accounting standards for Federally owned property, plant, and equipment (PP&E); and cleanup costs.

Property, Plant, And Equipment

The Federal Government's investment in PP&E exceeds $1 trillion[1] and includes many types of PP&E used for many different purposes. "PP&E" is defined as follows:

> Tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity.

The diversity among Federal PP&E creates a need for meaningful categories of PP&E with different accounting standards for each category. The categories of PP&E are:

- general PP&E are PP&E used to provide general government services or goods;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land[2] (i.e., land other than that included in general PP&E).

Complete accounting standards for *general PP&E* are included in this document.

General PP&E

The general PP&E category consists of items that:

- could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but are used by the Federal entity to produce goods or services, or to support the mission of the entity; or

[1]Department of the Treasury, Financial Management Service, *Consolidated Financial Statements of the United States Government*, prototype 1993, p. 23. The prototype statements provide gross historical cost investment amounts for all PP&E recorded by government entities. These amounts have not been audited.

[2]Land acquired for or in connection with *general PP&E* would be included in that category. Land not associated with general PP&E would be considered stewardship land.

- are used in business-type activities;[3] or
- are used by entities in activities whose costs can be compared to other entities (e.g., Federal hospitals compared with other hospitals).

General PP&E includes land acquired for or in connection with other general PP&E.[4]

General PP&E shall be reported in the basic financial statements: the balance sheet,[5] and the statement of net cost.[6] The acquisition cost of general PP&E shall be recognized[7] as an asset. Subsequently, except for land which is a nondepreciable asset, that acquisition cost shall be charged to expense through depreciation.[8] The depreciation expense shall be accumulated in a contra asset account—accumulated depreciation.

The Standards addressing internally-developed software have been amended by SFFAS 10, *Accounting for Internal Use Software.*[9]

In addition, the standard addresses donations, transfers, and retirements of general PP&E as well as disclosure[10] requirements.

[3] Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in the Board's exposure draft on *Revenue and Other Financing Sources*.

[4] "Acquired for or in connection with other general PP&E" is defined as 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.

[5] "Balance sheet" refers to the statement that reports on assets, liabilities, and net position of the entity at the end of the reporting period. This statement is referred to in OMB Bulletin 94-01, Form and Content of Agency Financial Statements, as the Statement of Financial Position.

[6] "Statement of Net Cost" refers to the statement providing information on the entity's flows of exchange revenues, expenses, gains, and losses. The Board presented this new statement in its Statement of Federal Financial Accounting Concepts 2, *Entity and Display*. In addition, the Board has exposed for comment a standard for reporting net costs and has provided an illustrative statement which might give effect to this standard in the ED on *Revenue and Other Financing Sources*, July, 1995.

[7] "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.

[8] "Depreciation" is the systematic and rational allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.

[9] See SFFAS 10.

[10] "Disclosure" refers to reporting information in notes regarded as an integral part of the basic financial statements.

Federal Mission PP&E

The requirements contained herein have been rescinded because the Federal Mission PP&E category was replaced by the National Defense PP&E term in SFFAS 11, but then ND PP&E was rescinded by SFFAS 23.[11, 12]

Heritage Assets and Stewardship Land

The requirements contained herein have been rescinded and replaced by SSFAS 29, *Heritage Assets and Stewardship Land*.

Deferred Maintenance

The Deferred Maintenance requirement contained herein have been rescinded and replaced by SFFAS 42, *Deferred Maintenance and Repairs*, Amending SFFAS 6, 14, 29, and 32. Information related to the condition and the estimated cost to remedy deferred maintenance of PP&E is to be reported as required supplementary information.

Cleanup Costs

Cleanup costs are the costs associated with hazardous waste removal, containment, or disposal. In some instances, the Federal Government incurs liabilities[13] for cleaning up hazardous waste at sites or facilities it operates or has operated. Generally, cleanup cannot be, or is not, done until permanent or temporary closure or shutdown of sites or facilities. The Board has completed accounting standards for liabilities which address liabilities for environmental cleanup resulting from an accident, natural disaster, or other one-time

[11]Footnotes 11 and 12 were rescinded with the removal of language relating to Federal Mission PP&E.

[12]Footnotes 11 and 12 were rescinded with the removal of language relating to Federal Mission PP&E.

[13]FASAB's Statement of Federal Financial Accounting Standards 5, Accounting for Liabilities of the Federal Government, recommends the following definition for liability: a probable future outflow or other sacrifice of resources as a result of past transactions or events. The standards require recognition, in general purpose Federal financial reports, of probable and measurable liabilities arising from past exchange transactions; government-related injuries or damage; or non-exchange amounts that, according to current law and applicable policy, are due and payable to the ultimate recipient. The standards also provide guidance for disclosures related to liabilities that are not both probable and measurable at the balance sheet date.

occurrence. Those liability standards do not address inter-period cost allocation when cleanup relates to operations that span many periods.

Therefore, the Board chose to provide additional guidance relative to cleanup costs in this standard. The additional standards in this statement provide for the timing of recognition of the liability and related operating expense.

For cleanup costs associated with general PP&E, probable[14] and measurable cleanup costs shall be allocated to operating periods benefiting from operations of the general PP&E. This allocation shall be based on a systematic and rational method. For example, the estimated cost could be allocated to operating periods based on the expected physical capacity of the PP&E and the amount of capacity used each period. In addition, disclosure of the total estimated cost is required.

For cleanup costs associated with stewardship PP&E, probable and measurable liabilities shall be recognized when the stewardship PP&E is placed in service. Simultaneous to recognizing the liability, the related expense for cleanup cost shall be recognized.

[14]The term "probable" means 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. For example, cleanup costs would be probable if (1) laws and regulations that have been approved as of the balance sheet date, regardless of the effective date of those laws and regulations, require cleanup or (2) compliance agreements (e.g., agreements with state or local authorities relating to the extent and the timing of remedial action) had been entered into by a Federal entity.

Table of Contents

Chapter 1: Introduction

Purpose

1. The purpose of this statement is to provide accounting standards for Federally owned property, plant, and equipment (PP&E); deferred maintenance; and cleanup costs. This introduction provides information on:

   - the scope of the standards,
   - consideration of reporting objectives,
   - applicability of the standards,
   - capitalization threshold,
   - materiality, and
   - effective date.

2. Chapters 2, 3, and 4 present the accounting standards for PP&E, deferred maintenance, and cleanup costs, respectively.

3. Appendix A presents the Basis for Conclusions. This appendix provides the Board's rationale for the decisions made and responds to the major issues raised in comment letters.

4. Appendix B presents illustrations to aid in categorizing PP&E.

5. Appendix C provides an example of a deferred maintenance disclosure.

6. Appendix D illustrates cleanup cost accounting.

7. Appendix E is a glossary of terms used in this statement [Omitted. See Consolidated Glossary in "Appendix E: Consolidated Glossary" on page 1.]

Scope

8. This statement identifies and defines categories of PP&E and addresses recognition and measurement of, and disclosure requirements associated with property, plant, and equipment (as well as land), including accounting for deferred maintenance and cleanup costs. This statement does not address natural resources. However, the Board is undertaking a project to address accounting for natural resources.

Reporting Objectives

9. In drafting accounting standards for PP&E, the Board relied on the Statement of Federal Financial Accounting Concepts Number 1, *Objectives of Federal Financial Reporting*. Ultimately, all accounting standards taken as a whole will help meet the four reporting objectives expressed in the Objectives statement: budgetary integrity, operating performance, stewardship, and systems and controls. The focus of these standards is on the two reporting objectives most relevant to PP&E—operating performance and stewardship. These objectives and how they could be met through PP&E accounting are discussed under the headings (1) operating performance, and (2) stewardship.

Operating Performance

10. The Board believes that it can contribute to meeting the operating performance objective[15] by measuring the cost associated with using property, plant, and equipment and including that cost in entity operating results. The Board first sought to identify PP&E costs that would be appropriate to include in operating expense. Then, from consideration of cost information required, the Board determined what balance sheet information would have to be reported.

11. 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 (e.g., program managers, budget examiners and officials),
- 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 (e.g., condition of assets including deferred maintenance).

[15]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. Federal financial reporting should provide information that helps the reader to determine:

a. the costs of providing specific programs and activities and the composition of, and changes in, these costs.
b. the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs.
c. the efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship

12. The Board believes that Federal financial reporting can fulfill the stewardship objective[16] if the Board provides standards that will result in reporting information on:

- asset condition;
- changes in the amount and service potential of property, plant, and equipment;
- cost of property, plant, and equipment where applicable; and
- spending for acquisition of property, plant, and equipment versus non-capital spending.

Capitalization Thresholds

13. The Board believes that capitalization thresholds should be established by Federal entities rather than centrally by the Board. Because Federal entities are diverse in size and in uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds. Once established, this threshold(s) should be consistently followed and disclosed in the financial reports.

Applicability

14. For guidance on the general applicability of this standard and all other Federal financial accounting standards please refer to Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

Materiality

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

[16]Federal financial reporting should assist 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 nations's financial condition have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:

a. whether the government's financial position improved or deteriorated over the period.
b. whether the future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
c. whether government operations have contributed to the nation's current and future well-being.

Effective Date

16. The Board recommends that the accounting standards presented in this proposed statement become effective for periods beginning after September 30, 1997. Earlier implementation is encouraged. In addition, under early implementation individual provisions of the accounting standards may be implemented before other provisions. For example, provisions for stewardship PP&E may be implemented before provisions for general PP&E.

Chapter 2: Property, Plant, And Equipment

Definitions

17. Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives[17] of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and
- they have been acquired or constructed with the intention of being used, or being available for use by the entity.

18. Property, plant, and equipment also includes:

- assets acquired through capital leases (See paragraph 20), including leasehold improvements;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[18]

[17]Useful life is the normal operating life in terms of utility to the owner. (adapted from Kohler's Dictionary for Accountants)

[18]"Land 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, and other like interests in land.

19. Property, plant, and equipment excludes items (1) held in anticipation of physical consumption such as operating materials and supplies[19] and (2) the Federal entity has a reversionary interest in.[20]

20. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [21] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.[22]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life[23] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value[24] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[21]Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.

[22]"Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.

[23]"Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.

[24]"Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)

[19]Accounting for operating materials and supplies is addressed in Statement of Federal Financial Accounting Standards No. 3 *Accounting for Inventory and Related Property*.

[20]The Federal Government sometimes retains an interest in PP&E acquired with grant money. In the event that the grant recipient no longer uses the PP&E in the activity for which the grant was originally provided the PP&E reverts to the Federal Government.

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SFFAS 54, *Leases*, as amended by SFFAS 58, will replace the requirements for lease accounting established in SFFAS 6 paragraphs 20 and 29 and the related footnotes, 21-24 and 35.

SFFAS 6 paragraph 20 will be rescinded for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

20 [See SFFAS 54 for revised standards regarding leases.][21,22, 23,24]

[21] [Footnote 21 rescinded by SFFAS 54.]

[22] [Footnote 22 rescinded by SFFAS 54.]

[23] [Footnote 23 rescinded by SFFAS 54.]

[24] [Footnote 24 rescinded by SFFAS 54.]

20A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[24.1] Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

20B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

- concession arrangements;
- grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;
- land sales or land exchanges;
- leases;

[24.1] Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

- permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;
- forest product sales such as timber, or sales arising from national forests and grasslands; and/or
- public-private partnerships.

20C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

20D. Operational land sub-category includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

- Military functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.
- Scientific functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).
- Nuclear functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.
- Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

Standards And Categories

21. 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*.

22. In determining which category PP&E should be placed in, it will be necessary to identify the “base unit”[25] of PP&E against which the category definitions will be applied. For example, units as large as entire facilities or as small as computers could be categorized. In determining the level at which categorization takes place, an entity should consider the cost of maintaining different accounting methods for property and the usefulness of the information, the diversity in the PP&E to be categorized (e.g., useful lives, value, alternative uses), the programs being served by the PP&E, and future disposition of the PP&E (e.g., transferred to other entities or scrapped).[26]

General Property, Plant, and Equipment

23. General property, plant, and equipment is any property, plant, and equipment used in providing goods or services. General PP&E typically has one or more of the following characteristics:

- it could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or services, or to support the mission of the entity, or
- it is used in business-type activities,[27] or

[25]“Base unit” refers to the level of detail considered in categorizing PP&E. Generally, the base unit is the smallest or least expensive item of property to be categorized. The term “base unit” may be used by others to have a different meaning—the meaning intended in this standard is limited to that specified above.

[26]The concept described here is intended for PP&E categorization purposes only. However, for the purpose of record keeping, greater detail may be necessary to maintain accountability for PP&E so that assets can be safeguarded against loss, theft, misappropriation, etc. Categorizing PP&E with less detail considered does not necessarily mean that (1) accounting systems or (2) property records must follow the same level of detail.

[27]Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in the Board’s exposure draft on *Revenue and Other Financing Sources*.

- it is used by entities in activities whose costs can be compared[28] to those of other entities performing similar activities (e.g., Federal hospital services in comparison to other hospitals).

24. For entities operating as business-type activities, all PP&E shall be categorized as general PP&E whether or not it meets the definition of any other PP&E categories.

25. Land and land rights acquired for or in connection with other general PP&E[29] shall be included in general PP&E unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.. In some instances, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.

Asset Recognition

26. **All general PP&E** shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

    - amounts paid to vendors;
    - transportation charges to the point of initial use;
    - handling and storage costs;
    - labor and other direct or indirect production costs (for assets produced or constructed);
    - engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
    - acquisition and preparation costs of buildings and other facilities;
    - an appropriate share of the cost of the equipment and facilities used in construction work;
    - fixed equipment and related installation costs required for activities in a building or facility;
    - direct costs of inspection, supervision, and administration of construction contracts and construction work;

[28]The Board is not making a recommendation that cost comparisons actually be made. Nor is it suggesting that costs can be easily compared for a Federal and non-Federal entity. If the activities are somewhat comparable then one should presume that a cost comparison **could** be made.

[29]"Acquired for or in connection with other general PP&E" is defined as 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.

- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.[30]

27. ... [See SFFAS 10 for revised standards regarding internally-developed software][31, 32, 33]

28. ... [See SFFAS 10 for revised standards regarding internally-developed software][34]

29. The cost of general PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard[35] unless the net present value exceeds the fair value of the asset).

[35]See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.

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SFFAS 54, Leases, as amended by SFFAS 58, will replace the requirements for lease accounting established in SFFAS 6 paragraphs 20 and 29 and the related footnotes, 21-24 and 35.

SFFAS 6 paragraph 29 will be rescinded for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

29. [See SFFAS 54 for revised standards regarding leases.][35]

[35] [Footnote 35 rescinded by SFFAS 54.]

30. The cost of general PP&E acquired through donation, devise,[36] or **judicial process** excluding forfeiture (See paragraph 33) shall be estimated fair value at the time acquired by the government.

[30]"Interest costs" refers to any interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E.

[31]Footnote 31 was rescinded by SFFAS 10.

[32]Footnote 32 was rescinded by SFFAS 10.

[33]Footnote 33 was rescinded by SFFAS 10.

[34]Footnote 34 was rescinded by SFFAS 10.

[36]A will or clause of a will disposing of property.

31. The cost of general PP&E **transferred from other Federal entities** shall be the cost recorded by the transferring entity for the PP&E net of accumulated depreciation or amortization. If the receiving entity cannot reasonably ascertain those amounts, the cost of the PP&E shall be its fair value at the time transferred.

32. The cost of general PP&E acquired through **exchange**[37] shall be the fair value of the PP&E surrendered at the time of exchange.[38] If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost shall be the fair value of PP&E acquired. If neither fair value is determinable the cost of the PP&E acquired shall be the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. Any difference between the net recorded amount of the PP&E surrendered and the cost of the PP&E acquired shall be recognized as a gain or loss. In the event that cash consideration is included in the exchange, the cost of general PP&E acquired shall be increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received.

33. The cost of general PP&E acquired through **forfeiture** shall be determined in accordance with Statement of Federal Financial Accounting Standards No. 3, ***Accounting for Inventory and Related Property*** (SFFAS 3).[39] Amounts recorded for forfeited assets based on SFFAS 3 shall be recognized as the cost of general PP&E when placed into official use.

34. PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity.[40] In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

Expense Recognition

35. Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of

[37]This paragraph applies only to exchanges between a Federal entity and a non-Federal entity. Exchanges between Federal entities shall be accounted for as transfers (See paragraph 31).

[38]If entity enters into an exchange in which the fair value of the PP&E acquired is less than that of the PP&E surrendered, the PP&E acquired shall be recognized at its cost as described in paragraph 32 and subsequently reduced to its fair value. A loss shall be recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value.

[39]SFFAS 3 requires that forfeited real and personal property be valued at market value less an allowance for any liens or claims from a third party.

[40]Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery. For PP&E acquired by a contractor on behalf of the entity (e.g., the entity will ultimately hold title to the PP&E), PP&E shall also be recognized upon delivery or constructive delivery whether to the contractor for use in performing contract services or to the entity.

the general PP&E. Depreciation expense shall be recognized on all general PP&E,[41] except land and land rights of unlimited duration.[42]

- Estimates of useful life of general PP&E must consider factors such as physical wear and tear and technological change (e.g., obsolescence).
- Various methods can be used to compute periodic depreciation expense so long as the method is systematic, rational, and best reflects the use of the PP&E.
- Any changes in estimated useful life or salvage/residual value shall be treated prospectively. The change shall be accounted for in the period of the change and future periods. No adjustments shall be made to previously recorded depreciation or amortization.
- A composite or group depreciation methodology,[42a] whereby the costs of PP&E are allocated using the same allocation rate, is permissable.

36. Depreciation expense shall be accumulated in a contra asset[43] account—accumulated depreciation. Amortization expense shall be accumulated in a contra asset account—accumulated amortization.
37. Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E.
38. In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized[44] shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

[41]Software and land [See SFFAS 10 for standard regarding internally developed software] rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. “Amortization” is applied to intangible assets in the same manner that depreciation is applied to general PP&E—tangible assets.

[42]Land rights that are for a specified period of time shall be depreciated or amortized over that time period.

[42a]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. 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.

[43]A contra asset account is an account which partially or wholly offsets an asset account. On financial statements they may be either merged or appear together.

[44]For example, amounts realized may include cash received for scrap materials or fair value of items received in exchange for PP&E removed from service.

39. General PP&E shall be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess. It shall be recorded in an appropriate asset account at its expected net realizable value. Any difference in the book value of the PP&E and its expected net realizable value shall be recognized as a gain or a loss in the period of adjustment. The expected net realizable value shall be adjusted at the end of each accounting period and any further adjustments in value recognized as a gain or a loss. However, no additional depreciation/amortization shall be taken once such assets are removed from general PP&E in anticipation of disposal, retirement, or removal from service.

Implementation Guidance

40. Alternative Methods for Establishing Opening Balances.[44A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

   a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[44B] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

   b. The application of these alternative methods based on the second condition specified in paragraph 40 is available to each reporting entity only once per line item.

   c. A reporting entity that meets either condition in paragraph 40 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial

[44A] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[44B] An unreserved assertion is an unconditional statement.

Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

d. Alternative Valuation Method. Deemed cost[44C] is an acceptable valuation method for opening balances of general PP&E. Because the reporting entity may have multiple component or subcomponent reporting entities[44D] using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[44E]

   i. Replacement cost[44F]

   ii. Estimated historical cost (initial amount). Reasonable estimates may be based on:

      1. cost of similar assets at the time of acquisition;

      2. current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or

      3. other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

   iii. Fair value[44G]

e. Establishing in-service dates.

[44C] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

[44D] SFFAS 47, *Reporting Entity*, provides that “component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

[44E] The methods are not listed in order of preference.

[44F] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life (Statement of Federal Financial Accounting Concepts (SFFAC) 7, Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording, par. 46).

[44G] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale (SFFAC 7, par. 38).

i. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.

ii. It is not necessary to separately identify the in-service date for material improvements [44H] included in the opening balances of a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.

f. Alternative methods for land and land rights. A reporting entity should choose among the following alternative methods for establishing an opening balance for land and land rights. Because a reporting entity may have multiple component or subcomponent reporting entities selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

i. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative method is applied, the reporting entity should expense future land and land right acquisitions.

ii. Land and land rights may be recognized in opening balances based on the provisions of the alternative valuation method (deemed cost) provided in paragraph 40.d.

g. Once established using alternative methods, opening balances are considered consistent with GAAP.

h. Component Reporting Entity Disclosures:

i. A component reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 40.f.i. to land and land rights should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an

[44H] Material improvements are costs which either extend the useful life of existing general PP&E or enlarge or improve its capacity.

unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures. In the event different alternative methods are applied to land and land rights (as permitted by paragraph 40.f.) by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

i. Financial Report of the U.S. Government Disclosures

   i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

   ii. When a component reporting entity elects to apply the provisions of paragraph 40.f.i. to land and land rights, the U. S. government-wide financial statements should disclose this fact, the number of acres held at the end of each reporting period, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

41. Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost[45] and depreciation/amortization charged over the remaining life based on that net remaining cost.

42. For general PP&E that would be substantially depreciated/amortized had it been recorded upon acquisition based on these standards, materiality and cost-benefit should be weighed heavily in determining estimates. Consideration should be given to:

[45]*Net remaining cost* is the original cost of the asset less any accumulated depreciation/amortization to date.

- recording only improvements made during the period beyond the initial expected useful life of general PP&E, and
- making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building by building estimate).

43. In recording existing general PP&E, the difference in amounts added to asset and contra asset accounts shall be credited (or charged) to Net Position of the entity. The amount of the adjustment shall be shown as a “prior period adjustment” in the statement of changes in net position. For published financial statements presenting prior year information, no prior year amounts shall be restated.
44. In the period that these standards are implemented, disclosure of the adjustments, by major class[46] of PP&E, made to general PP&E and accumulated depreciation/amortization is required.

Disclosure Requirements

45. The following are minimum G-PP&E disclosure requirements:
    - the cost, associated accumulated depreciation, and book value by major class;
    - the use and general basis of any estimates used;
    - the estimated useful lives for each major class;
    - the method(s) of depreciation for each major class;
    - capitalization threshold(s) including any changes in threshold(s) during the period; and
    - restrictions on the use or convertability of G-PP&E.

The listed disclosure requirements for G-PP&E and G-PP&E land are not applicable to the U.S. Government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. Government-wide financial statements for these activities.

... [paragraphs 46-56 and accompanying heading were rescinded by SFFAS 23, par. 9][47,48, 49,50,51]

[46]“Major classes” of general PP&E shall be determined by the entity. Examples of major classes include buildings and structures, furniture and fixtures, equipment, vehicles, and land.

[47][Footnote 47, was rescinded by SFFAS 23, par. 9]

[48][Footnote 48, was rescinded by SFFAS 23, par. 9]

[49][Footnote 49, was rescinded by SFFAS 23, par. 9]

[50][Footnote 50, was rescinded by SFFAS 23, par. 9]

[51][Footnote 51, was rescinded by SFFAS 23, par. 9]

45A. The following [RSI information: FY 2022-2025] [disclosures: FY 2026][46.1] should be provided regarding G-PP&E land and permanent land rights:

a. A concise statement defining an entity's federal land, and explaining how land relates to the mission of the entity.

b. A brief description of the entity's policies for land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

c. Land and permanent land rights should be assigned to one of three subcategories based on predominant use[461.a] and reported in estimated acres of land. The three sub-categories are c ommercial use land; conservation and preservation land; and operational land. Where land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land[461.b]. The following information should be presented by sub-category of land use:

    i. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at the end of each reporting period for land and permanent land rights should be provided.

d. If applicable, the amount of estimated acres held for disposal or exchange and their predominant use. For purposes of this Statement, land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

[46.1] Unless otherwise noted, [RSI information: FY 2022-2025] [disclosure: FY 2026] requirements are limited to the G-PP&E land category and are not required for each of the three subcategories of conservation and preservation land; operational land; and commercial use land.

[46.1a] Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

[46.1b] Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

e. Land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

45B. The financial statement balance sheet should reference a note that [presents RSI information: FY 2022-2025] [discloses: FY 2026] required at paragraph 45A (a through e) about G-PP&E land and permanent land rights but no asset dollar amount should be shown. Existing display and disclosures[46.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

Heritage Assets

... [paragraphs 57-65 were rescinded by SFFAS 29, par. 11] [52,53,54]

Stewardship Land

... [paragraphs 66-76 were rescinded by SFFAS 29, par. 30] [55,56,57]

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

[46.2]For G-PP&E land and land rights, existing disclosures are those that are in effect prior to the amendments contained in paragraph 45A. They include disclosures required by paragraph 40.h for those entities electing an alternative method for land and land rights and, if applicable, the minimum G-PP&E disclosure requirements as required by paragraph 45.

[52][Footnote 52 was rescinded by SFFAS 29.]

[53][Footnote 53 was rescinded by SFFAS 29.]

[54][Footnote 54 was rescinded by SFFAS 29.]

[55][Footnote 55 was rescinded by SFFAS 29.]

[56][Footnote 56 was rescinded by SFFAS 29.]

[57][Footnote 57 was rescinded by SFFAS 29.]

Chapter 3: Deferred Maintenance

Paragraphs 77 through 84 were rescinded by SFFAS 42[58,59,60,61,62,63,64,65]

Chapter 4: Cleanup Costs

Definition

85. Cleanup costs are the costs of removing, containing, and/or disposing of (1) hazardous waste (see paragraph 86) from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E.

86. Hazardous waste is 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.

87. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and postclosure costs.

[58][Footnote 58 was rescinded by SFFAS 42.]

[59][Footnote 59 was rescinded by SFFAS 42.]

[60][Footnote 60 was rescinded by SFFAS 42.]

[61][Footnote 61 was rescinded by SFFAS 42.]

[62][Footnote 62 was rescinded by SFFAS 42.]

[63][Footnote 63 was rescinded by SFFAS 42.]

[64][Footnote 64 was rescinded by SFFAS 42.]

[65][Footnote 65 was rescinded by SFFAS 42.]

Scope

88. This standard applies only to cleanup costs from Federal operations known to result in hazardous waste which the Federal Government is required by Federal, state and/or local statutes and/or regulations that have been approved as of the balance sheet date, regardless of the effective date, to cleanup (i.e., remove, contain or dispose of).[66] These cleanup costs meet the definition of liability provided in Statement of Recommended Accounting Standards no. 5, *Accounting for Liabilities of the Federal Government* (SRAS no. 5).

89. However, due to the nature of the liability and the timing associated with cleanup costs, additional guidance is provided in this standard on the recognition of cleanup costs over the life of the related PP&E. Guidance is required since cleanup can not occur until the end of the useful life of the PP&E or at regular intervals during that life.

90. This standard is intended to supplement the accounting requirements for liabilities in SRAS no. 5. SRAS no. 5 defines liabilities as a "probable future outflow or other sacrifice of resources as a result of past transactions or events." Further, SRAS no. 5 requires recognition of liabilities that are probable and measurable. Measurable means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable.

91. The recognition and measurement standards provided in this standard are subject to the criteria for recognition of liabilities included in SRAS no. 5. That is, liabilities shall be recognized when three conditions are met:

- a past transaction or event has occurred,
- a future outflow or other sacrifice of resources is probable,[67] and
- the future outflow or sacrifice of resources is measurable.[68]

[66]Accounting for environmental liabilities such as cleanup costs is currently undergoing change—due to both improved measurement techniques and increased attention from the accounting community. The Board will monitor these changes and revisit these standards as needed.

[67]Probable means that the future confirming event or events is more likely than not to occur.

[68]The unit of analysis for estimating liabilities can vary based on the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, an estimate of the cleanup costs could be made on a facility by facility basis, or an entity by entity basis.

92. SRAS no. 5 also provides for disclosure of liabilities that do not meet all of the above criteria; these standards apply to cleanup costs as well.

93. Other cleanup costs, such as those resulting from accidents or where cleanup is an ongoing part of operations, are to be accounted for in accordance with liability standards and are not subject to the recognition guidance provided in this standard. This guidance does not apply to these other types of cleanup since the cleanup effort is not deferred until operation of associated PP&E ceases either permanently or temporarily.[69]

Recognition And Measurement

Estimation Methods

94. Cleanup costs, as defined above, shall be estimated when the associated PP&E is placed in service. The estimate shall be referred to as the “estimated total cleanup cost.” There are two approaches to recognizing this total—one applies to general PP&E and another to stewardship PP&E.

95. The estimate shall contemplate:

- the cleanup plan, including
  - level of restoration to be performed,
  - current legal or regulatory requirements,[70] 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.

96. Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

[69]Cleanup may be deferred for other reasons, such as availability of resources. However, this type of deferral does not affect the recognition of the liability.

[70]Laws and regulations approved as of the balance sheet date, regardless of the effective date of those laws and regulations, shall be considered.

Cleanup Cost for General PP&E

97. A portion of estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E (e.g., expected usable landfill area) whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as the basis for systematic and rational recognition of expense and accumulation of the liability.

98. Recognition of the expense and accumulation of the liability shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation.

99. As reestimates (see paragraph 96) are made, the cumulative effect of changes in total estimated cleanup costs related to current and past operations shall be recognized as expense and the liability adjusted in the period of the change in estimate.

100. As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

Cleanup Cost for Stewardship PP&E

101. Consistent with the treatment of the acquisition cost of stewardship PP&E (i.e., expensing in the period placed in service), the total estimated cleanup cost shall be recognized as expense in the period that the stewardship asset is placed in service and a liability established.

102. The liability shall be adjusted when the estimated total cleanup costs are reestimated as described in paragraph 96. Adjustments to the liability shall be recognized in expense as “changes in estimated cleanup costs from prior periods.”

103. As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

Implementation Guidance

104. Two implementation approaches have been provided for liabilities related to general PP&E in service at the effective date of this standard:

- A liability shall be recognized for the portion of the estimated total cleanup cost that is attributable to that portion of the physical capacity used or that portion of the estimated useful life that has passed since the PP&E was placed in service. The remaining cost shall be allocated as provided in paragraphs 97 through 99.
- If costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total cleanup cost as a liability upon implementation. In addition, in periods following the implementation period, any changes in the estimated total cleanup cost shall be expensed when reestimates occur and the liability balance adjusted. The provisions for cost allocation provided in paragraphs 97 through 99 shall not apply under this implementation method.

105. The offsetting charge for any liability recognized upon implementation shall be made to Net Position of the entity. The amount of the adjustment shall be shown as a “prior period adjustment” in any statement of changes in net position that may be required. No amounts shall be recognized as expense in the period of implementation. The amounts involved shall be disclosed and to the extent possible the amount associated with current and prior periods should be noted.

106. For stewardship PP&E that are in service at the effective date of this standard, the liability for cleanup costs shall be recognized and an adjustment made to the Net Position of the entity. The amount of the adjustment shall be shown as a “prior period adjustment” in any statement of changes in net position that may be required. The amounts involved shall be disclosed.

Disclosure Requirements

107. The sources (applicable laws and regulations) of cleanup requirements. The U.S. government-wide financial statements need not disclose the sources of cleanup requirements.

108. The method for assigning estimated total cleanup costs to current operating periods (e.g., physical capacity versus passage of time). The U.S. government financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods.

109. For cleanup cost associated with general PP&E, the unrecognized portion of estimated total cleanup costs (e.g., the estimated total cleanup costs less the cumulative amounts charged to expense at the balance sheet date). SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E.

110. Material changes in total estimated cleanup costs due to changes in laws, technology, or plans shall be disclosed. In addition, the portion of the change in estimate that relates to

prior period operations shall be disclosed. The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations.

111. The nature of estimates and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.

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

Appendix A: Basis For Conclusions

112. This appendix summarizes significant considerations by the Board in reaching the conclusions in this statement. In the following paragraphs, the Board's considerations in developing these standards as well as positions on specific issues raised in alternative views, comment letters, and during public hearings are explained. The Board relied extensively on input from a task force on Capital Expenditures as well as a small working subgroup on Physical Property. These paragraphs include reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

113. This appendix addresses each of the three standards in sequence.

Property, Plant, And Equipment

Background

114. Before addressing specific issues resolved following issuance of the exposure draft, this section provides a broad basis for the main provisions of the standard on investments in PP&E. The Federal Government makes many expenditures that can be characterized as investments or investment-type expenditures. These include expenditures for Federally owned PP&E.

115. Accounting for expenditures for PP&E as well as for the existing stock of PP&E is a significant undertaking because the Federal Government owns substantial amounts of diverse PP&E. Federal PP&E includes approximately 650 million acres of land, buildings containing over 1.5 billion square feet of floor space, many different forms of equipment, and military hardware.

116. These are used for a wide range of purposes; including, among others, operating, defense, conservation, and heritage purposes. Some of these purposes relate to the Federal Government's responsibility to provide for the Nation's common defense and general welfare. Specific types of PP&E are used by the Federal Government to meet this

responsibility. Other types of PP&E are held and used for operating purposes that are not unlike those of non-federal entities.

117. Some Federal operations are similar to profit-seeking enterprises and can be described as business-type activities. However, these business-type activities account for a small portion of the investment in PP&E. The majority of the investment in PP&E is used to provide government services and goods where user charges are not the primary source of revenues.

118. The Board found that a single accounting method for such diverse Federal PP&E would not meet the objectives established in its *Objectives of Federal Financial Reporting*. Therefore, the Board identified categories of PP&E and set different accounting methods for each category.

Categories Required

119. The PP&E standards incorporate the following categories:

- general PP&E are PP&E used to provide general government services;
- Federal mission PP&E are PP&E that are an integral part of the output of certain unique Federal Government missions;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land[71] is land other than that included in general PP&E.

120. The latter three categories of assets are referred to as stewardship PP&E. The term “stewardship PP&E” is used simply to refer to those categories of PP&E to be reported on a stewardship report.

General PP&E

121. General PP&E are items used to provide general government services; including PP&E that:

- could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or services, or to support the mission of the entity, or
- is used in business-type activities, or

[71]Note that land acquired for or in connection with general PP&E would be included in that category. All other land would be subject to stewardship reporting and is referred to throughout this document as stewardship land.

- is used by entities whose costs can be compared to other entities (e.g., Federal hospital services in comparison to other hospitals).

122. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. The Board's concepts statement, *Objectives of Federal Financial Reporting*, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information.

Stewardship PP&E

123. For stewardship PP&E,[72] the predominant reporting objective is stewardship. This is in contrast to general PP&E, for which the Board is concerned with providing information to assess operating performance and, therefore, provided for depreciation accounting. The most relevant information is about the existence of stewardship PP&E and that information can be provided through a new type of reporting—supplementary stewardship reporting.

124. For stewardship PP&E, the Board believes that allocation of historical cost to operating expense for each period would not contribute to the measurement of entity operating performance. Prior to issuing its *Objectives* statement, the Board conducted a user needs study and met with representatives of a wide variety of user groups. Most users specifically indicated that depreciating stewardship PP&E such as weapons systems would not provide meaningful information for assessing the entity's operating performance. The Board believes that its standards should address the needs of users and the Board has found that users do not need information which includes depreciation expense on this category of PP&E.

125. The Board noted in its *Objectives* statement that the government's responsibility for the nation's common defense and general welfare is unique and that, in some cases, the most relevant measures of performance are nonfinancial.[73] Despite the preference for nonfinancial performance measures for stewardship PP&E, the government must demonstrate that it is being an appropriate "steward" for these assets. To meet the stewardship objective, the government must be able to answer basic questions such as:

- What and where are the important assets?
- Is the government effectively managing and safeguarding its assets?

[72]The term "stewardship PP&E" is used to refer collectively to federal mission PP&E, heritage assets, and stewardship land.

[73]*Objectives*, paragraph 54.

126. Answers to these questions can be provided through supplementary stewardship reporting. The stewardship information provided would not necessarily have the same measurement basis as information shown on the balance sheet. Information could include value, quantity, and capacity depending on the category being reported on. These types of information are not typically found in balance sheet reporting. (Also, see discussion of deferred maintenance in paragraph 171 through 181 regarding other information that users consider relevant.)

127. The Board is addressing supplementary stewardship reporting in another standard. The information to be provided for stewardship PP&E is proposed in detail in that standard. Each of the stewardship PP&E categories are discussed further in the following paragraphs.

Federal Mission PP&E

128. Federal mission PP&E are specific PP&E acquired to provide a unique good or service for which there is not necessarily a periodic output against which to match costs. For example, the existence of and readiness of weapons systems supports national defense regardless of their actual combat use on a period by period basis. Also, space exploration equipment is used in long-term research efforts which may or may not produce an output each period but which nevertheless benefits the nation in the long run.

129. The standard specifically identifies weapons systems and space exploration equipment as Federal mission PP&E as well as providing a list of characteristics of Federal mission PP&E. The Board articulated characteristics of Federal mission PP&E because it recognizes that there are other types of PP&E, or PP&E may be developed in the future, that are similar to these two items. To be categorized as Federal mission PP&E an item shall meet at least one characteristic from each of the following two types of characteristics.

130. Characteristics related to the use of Federal mission PP&E are that it:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war or natural disaster; or
- is specifically designed for use in a program for which there is no other program or entity (Federal or non-Federal) using similar PP&E with which to compare costs.

131. Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life[74] due to the manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or of premature obsolescence.

[74]This may be evidenced by the ability (1) to retire the PP&E and later return it to service, or (2) to continually upgrade the PP&E to maintain its usefulness. In addition, PP&E that is held for “one-time” use, such as a warhead, has an indeterminate life.

132. The cost of Federal mission PP&E acquired during the period be shown on the operating statement.

Heritage assets

133. Heritage assets are held for their cultural, architectural, or aesthetic characteristics. Users have identified nonfinancial information as being relevant for these assets. For assessing operating performance, the Board believes that relevant cost information is provided through reporting of periodic maintenance cost since heritage assets are intended to be preserved as national treasures. It is anticipated that they will be maintained in reasonable repair and that there will be no diminution in their usefulness over time.

134. In addition to assets held purely for heritage purposes (e.g., the Washington Monument), the Federal Government uses heritage assets in its day-to-day operations. For example, many Federal office buildings, such as the Old Executive Office Building, have monumental characteristics. The Board considered whether these multi-use heritage assets would be more appropriately categorized as general PP&E.

135. Despite their heritage characteristics, these assets serve a function that could otherwise be served by assets that do not possess heritage characteristics. Therefore, the standards provide that costs of reconstruction, renovation, or improvements that are directly associated with supporting operations be treated in a manner consistent with general PP&E. The Board based this decision on the need to measure cost for operations and to compare cost between entities.

Stewardship Land

136. The Federal Government owns vast amounts of land and its use of land is diverse. In some instances Federal land is integral to the ownership of general PP&E. For example, the cost of land upon which an office building is sited is integral to the cost of that building. Land acquired for or in connection with general PP&E will be recognized on the balance sheet to provide a more comprehensive measure of the assets devoted to general government operations. However, since land is not a depreciating asset, depreciation expense will not be recognized on land included in general PP&E.

137. Most Federal land is not directly related to general PP&E. For example, the national parks and forests are not used to support general PP&E. The Board concluded that land other than that acquired for or in connection with other general PP&E should not be reported on the balance sheet. This is consistent with the Board's treatment of heritage assets in that much of the government's land is held for the general welfare of the nation and is intended to be preserved and protected.

Issues

138. Following issuance of the ED, the Board specifically considered several issues related to the PP&E standard. These issues are addressed in the sequence that they appear in the standard.

Definitions

139. The Board asked respondents to comment on the appropriateness of the definitions of PP&E, general PP&E, Federal mission PP&E, heritage assets, and stewardship land. Respondents raised issues on the overall definition of PP&E including (1) internally-developed software, (2) land rights, (3) capitalization threshold, and (4) reversionary interests in property. These four issues are discussed below. An issue raised regarding the Federal mission PP&E definition is also addressed below.

Internally-developed Software

140. The ED proposed that internally-developed software be excluded from PP&E—in effect, that it be expensed when incurred. In making this proposal, the Board pointed to concerns affecting the objectivity/accuracy of any capitalized cost for internally-developed software in general PP&E.[75] The Board was concerned that costs could be overcapitalized thus understating expense for the period and that it would be difficult to provide for the removal or write-off of costs related to unsuccessful projects and/or cost overruns. Given these practical concerns and the expectation that costs for software development efforts would not fluctuate dramatically since they related to continuous agency efforts, the Board proposed that these costs be expensed.[76]

141. Many respondents supported the Board's view. They noted that, among other problems, it would be difficult to distinguish new development efforts from ongoing system maintenance. In fact, some respondents commented that software undergoes continuous improvement and updating.

142. On the other hand, the majority of respondents objected to the exclusion of these costs from PP&E. Many argued that internally-developed software met the overall definition of PP&E and that accounting could accommodate the problems of cost overruns and unsuccessful efforts. Many suggested that costs be held in a work-in-process account and any

[75]Internally-developed software may be a component of general PP&E or stewardship PP&E.

[76]In fact, the majority of private-sector entities do not capitalize the cost of internally-developed software. The Financial Accounting Standards Board has not developed guidance on this issue.

unsuccessful efforts subsequently written off in the period deemed unsuccessful. In addition, many believed that cost overruns were appropriate to include in the cost of the asset.

143. Ultimately, the Board made two changes to the PP&E definitions— they removed the statement excluding internally-developed software from PP&E and they added a provision for recognition of internally-developed software as a component of general PP&E under certain circumstances. Since the Board’s concern was with the potential for overcapitalization of these costs, they found that it was not necessary to exclude the costs from the PP&E categories for which costs would not be capitalized. Therefore, any internally-developed software costs appropriately classified as an item of stewardship PP&E may be included in those categories.

144. For internally-developed software costs that would be categorized as general PP&E, the Board placed several restrictions on the capitalization of costs. To be capitalized, it must be intended that the costs be recovered through charges to users. In addition, only certain costs may be capitalized after it has been established that the software project is likely to be successful. Once capitalized, the costs can not be amortized over a period longer than five years.

145. In addition to internally-developed software, the Board discussed accounting for contractor-developed software. In principle, the Board’s consensus was that the same accounting should be provided for contractor-developed software as for internally-developed software. However, the Board believed that this proposal should be exposed for comment prior to establishing a standard to that effect. Therefore, the standards do not provide specific provisions restricting the capitalization of contractor-developed software.

Land Rights

146. The Board received a request to address restrictive easements acquired by a Federal agency. This agency acquires restrictive easements limiting the use of land adjoining the agency’s own property. The Board considers these easements a “land right.” Land rights are interests and privileges held by an entity in land owned by others.

147. The Board provided for the recognition of land rights as part of PP&E since they are generally associated with other items of PP&E actually owned by the entity. In addition, where land rights are for a limited period of time and are includable in the general PP&E category, the Board provided for depreciation of the cost.

Capitalization Threshold

148. Many respondents requested that the Board provide a capitalization threshold as an element of the PP&E definition. The Board addressed this issue in developing the ED. At that time, the Board carefully considered whether to take a prescriptive approach by setting a threshold or to permit entities the latitude to establish a threshold suited to their particular operating environment. The Board believes that Federal entities are sufficiently diverse that one threshold would not be suitable for all entities. For example, Title 2's $5,000 threshold would be immaterial for defense department operations but perhaps not for a smaller entity such as the Small Business Administration.

149. Instead of setting a specific threshold, the Board has adopted a materiality approach—just as is done in private sector accounting. Each entity would establish its own threshold as well as guidance on applying the threshold to bulk purchases. The Board believes that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

Reversionary Interests in PP&E

150. The Board also received a request to address reversionary interests in PP&E. In some instances, the Federal Government provides grants to state and local governments for the acquisition of PP&E. If the state or local government eventually decides that it no longer needs to use the PP&E for the purpose specified in the original grant there is often a provision that the PP&E must revert to Federal ownership. In these cases, the Federal Government maintains a reversionary interest in PP&E. In essence, these are contingent assets and should not be recognized on the balance sheet. The Board elected to specifically exclude these items from PP&E.

Federal Mission PP&E

151. Some respondents indicated that the term "Federal mission PP&E" had broader implications than intended by its definition. It was suggested that some may assume any PP&E used to meet an agency's mission would fit this category (e.g., essentially all Federally owned PP&E).

152. The Board agreed that it was possible that a mere reading of the term "Federal mission PP&E" could lead to broader application of the category than permitted under the standard. However, the Board found that there was no brief term that would effectively communicate the nature of the PP&E properly includable in this category. The Board believes that the characteristics provided as well as the illustrations included in Appendix B of this document will clearly establish the appropriate use of this category. In addition, the Board has

incorporated in the standard a cautionary footnote regarding loose interpretations drawn from the term “Federal mission PP&E.”

Depreciation

153. The exposure draft posed several questions related to depreciation accounting for general PP&E. Briefly, the questions addressed:

- usefulness of depreciation expense for the assessment of operating performance,
- an alternative view suggesting that depreciation accounting be limited to business-type activities,
- usefulness of the allocation of depreciation expense to responsibility segments, and
- cost/benefit of allocating depreciation expense to programs

154. Overall, the respondents supported the Board’s proposal to require depreciation accounting on all general PP&E. Many indicated that depreciation accounting would improve performance measurement by producing comprehensive, comparable cost information. In addition, operating expenses would not be overstated in periods that assets were purchased and understated in other periods.

155. A few respondents supported the alternative view that would limit depreciation accounting to business-type activities. They argued that depreciation was only necessary where expenses were to be matched to revenues. This view is contrary to the operating performance objective and would not support development of cost information to associate with performance measures.

156. The Board did not make any changes to its requirements to apply depreciation accounting to general PP&E.

Multi-use Heritage Assets

157. The ED addressed renovation, reconstruction, improvement, and rebuilding costs for multi-use heritage assets (e.g., monumental style office buildings). Under the ED’s proposal, any costs not directly associated with the heritage nature of the asset would be capitalized and depreciated as general PP&E. The ED also provided that abnormally high costs due to the heritage features of the assets (e.g., replacement of a specialized roofing material versus a modern day equivalent) be treated as heritage asset costs.

158. Respondents indicated that it would be very difficult to apply the proposed standards. Difficulties would include segregating the cost associated with preserving the heritage assets and supporting operations as well as identifying abnormal costs. In response to these concerns, the Board modified the treatment of multi-use heritage assets. The

standard now provides that only renovation, reconstruction, and improvement costs directly attributable to operations be capitalized as general PP&E.

Current Value

159. The ED included an alternative view espousing the use of current value accounting for Federal Government PP&E. This view was not supported by the respondents. The majority of respondents believed that current values would be difficult and costly to obtain, and subject to manipulation. Many indicated that current values were often useful to decision makers and should be provided on an as needed basis rather than incorporated in the basic financial statements.

Federal Mission PP&E

160. Overall, the reaction to the Federal mission PP&E category was favorable. Respondents indicated that they would not have difficulty applying the category descriptions. However, the Board received the following specific requests for major revisions in the Federal mission PP&E category:

- to retain the definition but include Federal mission PP&E on the balance sheet and apply depreciation accounting to these assets, and
- to make use of the category optional (e.g., managers would be free to use the general PP&E category for PP&E that would otherwise qualify as Federal mission PP&E).

Depreciate Federal Mission PP&E

161. The Board did not adopt the first proposal—to apply depreciation accounting to Federal mission PP&E. While there may be management uses of this information, no persuasive examples of management uses have been identified. The Board remains convinced that depreciation accounting for these unusual items of PP&E would not provide meaningful information—a view that is supported by the Board’s 1992 user needs study. Further, the Board wishes to note that nothing precludes management from developing depreciation information through cost finding means if it desires to do so for particular management purposes.

Make the Federal Mission PP&E Category Permissive

162. It was proposed that classification of PP&E as Federal mission be permissive rather than mandatory. Two reasons were given for this proposal:

- some PP&E is used as both Federal mission and general PP&E (for example, office facilities located at nuclear weapons production plants), and

- entity management should be free to decide that depreciation information on Federal mission PP&E is useful.

163. It was suggested that adopting this proposal would allow agencies to classify property as best suits their needs. The Board discussed this proposal at length. Some Board members were favorably inclined to permit entity managers to exercise judgment regarding the accounting treatment of Federal mission PP&E. However, the majority of the Board members believed that making the category optional would be inappropriate.

164. These members argued that (1) the user needs study supported their belief that historical cost depreciation on these types of items was not useful, (2) it would not be appropriate to give entities the latitude to use different accounting methods for similar assets, and (3) it would not be cost-beneficial to permit entities to make item by item judgments on appropriate accounting treatment. The members noted that, in connection with the proposal to require depreciation accounting for Federal mission PP&E (See paragraph 161), they had not been able to identify any management uses of depreciation information on Federal mission PP&E. The Board was concerned that entities may make unsupported, and costly, decisions regarding the election to categorize items as general or Federal mission PP&E. While entities can use cost finding to determine depreciation expense for internal purposes if they so desire, the Board does not believe that depreciation of Federal mission PP&E would be useful for general purpose financial reports.

165. The Board decided that use of the Federal mission PP&E category would remain mandatory for PP&E exhibiting the designated characteristics. The Board did add guidance in the standard regarding the selection of the base unit to be used in categorizing PP&E (See paragraph). One respondent had proposed that this guidance be added and stated that it would aid entities in establishing the level of detail necessary to properly categorize PP&E. For example, should PP&E be categorized on a site by site basis or by a smaller unit such as building by building. As with the capitalization threshold, the Board has indicated the factors that should enter into the selection of a base unit but has ultimately left the actual selection up to management.

Other PP&E Meeting the Characteristics

166. The Board posed a question in the ED regarding the classification of **nuclear weapons production facilities** and **military base facilities** as Federal mission PP&E.[77] This question was posed because of a discussion among the Board members as to whether these items would or would not meet the Federal mission PP&E definition.

[77]FASAB Exposure Draft, *Accounting for Property, Plant, and Equipment*, February 28, 1995, page 19, paragraph 71, Item IC.

167. The majority of the respondents indicated that nuclear weapons production facilities meet the current characteristics of Federal mission PP&E—confirming the initial reaction of the Board members. One respondent did indicate that these facilities could be converted to other uses—as had munitions plants following World War II—however, the Board believes that the cost of such a conversion would be so great as to make it improbable in the near term. The Board has not elected to add this as another specifically identified item that qualifies as Federal mission PP&E because it is a good illustration of the purpose and application of the characteristics developed. In addition, the Board prefers not to engage in an exercise of listing all items that qualify since the absence of certain items may lead practitioners to assume that an item was specifically excluded.

168. The majority of respondents indicated that military base facilities would not as a group meet the definition of Federal mission PP&E and that the category should not be expanded to accommodate these assets. Many respondents pointed out that military base facilities have alternative uses and are currently being reviewed for just that purpose. The Board agrees with these views and has not modified the definition to permit inclusion of military base facilities in the category.

Audit of Federal Mission PP&E

169. Several respondents expressed concern regarding the level of audit coverage applicable to Federal mission PP&E. Although the ED did not specifically address supplementary stewardship reporting for those categories of PP&E removed from the balance sheet, there was concern that removing these categories would lessen the audit coverage. Respondents noted that military weapons systems and space exploration equipment represented a substantial investment. They were concerned that the changes could lead to poor tracking systems for these items as well as weak internal controls over them. Other respondents pointed out that the key information is the existence and condition of these assets rather than the historical cost of the items. In addition, they suggested that devoting audit resources to verifying historical cost dollar amounts would detract from auditing more important existence and condition information.

170. The Board responded with the following points:

- auditing standards are beyond the scope of the Board's responsibilities,
- Board members representing the Government Accountability Office (GAO) and the Office of Management and Budget (OMB) indicated that the audit coverage would be appropriately addressed in their work on Federal audit requirements,
- accounting standards should be established based on information needs not audit concerns, and

- the ED on supplementary stewardship reporting will include a statement to the effect that the Board expects that the responsible parties will produce audit requirements to satisfy concerns of the respondents.

Deferred Maintenance

171. The deferred maintenance standard was well received by the majority of respondents. The Board addressed the issue in part due to the many state and local governments as well as national groups that concerned over the deteriorating condition of government owned PP&E. A report of the U.S. Advisory Commission on Intergovernmental Relations (ACIR), High Performance Public Works,[78] notes that maintenance competes for funding with other government programs and is often underfunded. Contributing to this underfunding is the fact that the consequences of underfunding maintenance are often not immediately reported. The consequences include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations.

172. The ACIR recommended that entities disclose information on:

- the condition of assets,
- the cost of unfunded maintenance,
- the consequences of unfunded maintenance, and
- the uncertainty in estimates of unfunded maintenance.

173. The Capital Expenditures task force also recognized that deferred maintenance was an issue for Federal PP&E and requested that the Board address it. The policies and initiatives related to deferred maintenance at three Federal agencies[79] were reviewed and it was found that Federal agencies are developing systems to report on deferred maintenance. Although the systems are different, the goals of the systems are consistent—to provide reliable information on the condition of PP&E and to estimate the cost of correcting deficiencies.

174. Under these accounting standards, deferred maintenance information will be incorporated in the financial reports despite the differences in measurement among the agencies. The Board believes that deferred maintenance is a cost—a cost that management, at whatever

[78]U.S. Advisory Commission on Intergovernmental Relations, High Performance Public Works: A New Federal Infrastructure Investment Strategy for America, November 1993.

[79]These agencies are the Department of Energy, the Department of the Navy, and the National Aeronautics and Space Administration.

level, has elected not to fund. However, the Board found that deferred maintenance is not sufficiently measurable to be recognized in the accounting systems.

175. However, to highlight the reality that the cost remains despite being unfunded, the standards provide that deferred maintenance be disclosed by placing a line item on the statement of net cost with a note reference in lieu of a dollar amount on the financial statements. This recommendation is consistent with the findings of the Board's user needs study; that information on the cost of deferred maintenance is important to users. In addition, due to the measurement differences between entities, the disclosure requirements are flexible.

176. The standards provide two alternatives for estimating amounts to be disclosed—condition assessment surveys and life cycle cost analyses. Condition assessment surveys would provide disclosure of the estimated cost to return the PP&E to its desired condition. Life cycle cost analyses would highlight differences between planned maintenance and actual maintenance.

177. Both of these methods will be under the control of entity program managers since deferred maintenance is dependent on the purpose for which PP&E is held and on judgment regarding what condition PP&E should be in to meet that purpose. Entities are permitted flexibility in
(1) setting standards for maintenance requirements and (2) establishing cost beneficial methods to estimate the cost of deferred maintenance.

178. The proposed standards require disclosure of information on the condition of PP&E, estimates of the cost of deferred maintenance, and methods used to assess deferred maintenance. The standards apply to both PP&E reported on the balance sheet and the stewardship report.

179. In response to the ED, two opposing suggestions were raised—(1) recognize the amounts as a liability, and (2) remove the information from the notes.

Recognition

180. A few respondents, including two appearing at the public hearing, suggested that the Board provide for recognition of the liability associated with deferred maintenance. The Board does not believe that deferred maintenance can or should be recognized as a liability because it is not sufficiently measurable to be recognized. Deferred maintenance reporting is in an evolutionary phase with Federal agencies currently developing a variety of systems to assess deferred maintenance. Measurement can not be described at this time as consistent or comparable. The deferred maintenance standard will remain as drafted. However, if and when government maintenance standards (e.g., minimum acceptable condition and

standard repair costs) are set, the Board will revisit the accounting and consider requiring recognition of the liability and the cost.

Remove From Notes

181. A few respondents requested that the Board provide for deferred maintenance information through required supplemental information to lessen the audit burden associated with the information. The Board—as was the case with Federal mission PP&E—does not believe that audit coverage should govern the placement of information in the annual reports. Deferred maintenance information is considered important because it ensures that readers are informed of the condition of Federally owned PP&E. If there is a need to reduce the audit coverage, the Board believes that GAO and OMB can best address this need.

Cleanup Cost

182. The Board elected to address cleanup costs from long-term Federal operations as one of the costs associated with PP&E. For example, the Federal Government operates nuclear facilities and is required by law to cleanup any hazardous materials upon closing the facilities. This obligation meets the Board's definition of liability.[80] However, because the cleanup of these types of facilities would not occur until operations cease, additional guidance is needed to determine when and how to recognize these costs and liabilities.

183. The guidance in this standard builds on the accounting standards developed for liabilities. These standards were published in the Board's statement entitled *Accounting for Liabilities of the Federal Government* (liabilities standard). The liabilities standard includes:

- the liability definition,
- recognition criteria, and
- disclosure requirements.

184. The liabilities standard is applicable to cleanup costs. For example, if cleanup costs are not both probable and measurable the disclosure requirements in the liabilities standard would apply. The standards in this statement address cleanup cost accounting including:

- allocating cleanup costs to operating periods,
- estimating cleanup costs to be paid far in the future (e.g., using a current cost approach), and
- recognizing changes in estimates prior to actual cleanup.

[80] FASAB, Recommended Accounting Standard No. 5, *Accounting for Liabilities*, September 1995.

185. Because of the differences in accounting for the costs of general PP&E and stewardship PP&E, the Board developed different methods for allocating cleanup costs to operating periods depending on the category of the related PP&E.

Cleanup of General PP&E

186. The Board concluded that the liability for cleanup costs related to the operation of general PP&E would be recognized in a systematic and rational manner over the periods that the associated general PP&E is in use. This approach is consistent with the requirement to depreciate general PP&E. In addition, the Board requires disclosure of the estimate of total cleanup costs.

Cleanup Of Stewardship PP&E

187. For cleanup costs related to stewardship PP&E, the Board concluded that the total estimated liability for cleanup cost would be recognized at the time that the stewardship PP&E is placed in service. This is consistent with the treatment of the acquisition cost of the stewardship PP&E which is recognized as a cost of operations in the period that the PP&E is placed in service.

Estimating Cleanup Costs

188. With regard to estimating cleanup cost, the Board concluded that the estimate would be based on the current cost to perform the cleanup. Current cost should be based on existing laws, technology and management plans. An alternative to current cost would have been to estimate costs in the future, factoring in expected inflation, and discounting this amount to current dollars. The Board did not believe that this approach offered any greater degree of accuracy in return for the additional effort involved in making the estimate.

189. As with all estimates, the estimates of cleanup costs will change over time. These changes will be due to inflation as well as to changes in laws and technology.

190. For cleanup costs associated with general PP&E, changes in estimates related to current and prior period operations be recognized as an expense in the period of the change. For example, if a facility with a capacity to produce 100 tons of material has produced 60 tons of material, then 60% of the change in estimate should be recognized as expense in the year that the estimate changes.

191. For cleanup costs associated with stewardship PP&E, the total change in estimate be recognized in the period of the change.

Cleanup Cost Issues

192. Respondents to the ED were supportive of the Board's efforts to address cleanup costs. However, several suggested that the Board's treatment of the liability associated with general PP&E—recognizing it incrementally over the life of the PP&E—was inconsistent with its definition of a liability. In some cases, respondents argued, the cleanup liability is incurred at the time the PP&E is placed in service. These respondents suggested that the Board provide for full recognition of the liability if an amount is reasonably measurable at that time.

193. The Board did not adopt this suggestion. While the Board recognizes that in fact the liability may be incurred at the date that general PP&E is put in service, the actual recognition of the liability is problematic in a double entry accounting system. Generally, the recognition of a liability, a credit account, generates a concurrent recognition of either an expense (e.g., accounts payable for fuel bills is offset by fuel expense) or an asset (e.g., a capital lease liability is offset by an asset—PP&E), both typically debit accounts. In this case, the cleanup cost is not appropriately includable in operating expense of the period that the PP&E is placed in service. This would create a need for a balance sheet debit to offset the liability.

194. The Board does not believe that it would be appropriate to recognize an asset to offset the cleanup liability. Although some argue cleanup cost is a deferred cost of associated PP&E, the Board does not believe that these costs meet the asset definition and finds that recognition of cleanup cost as a component of PP&E would significantly overstate assets.

195. Other respondents expressed the opposite position, suggesting that it is not appropriate to recognize cleanup costs until they are budgeted for. This approach is not only inconsistent with the definition of a liability but would keep users of the financial statements in the dark as to the magnitude of Federal commitments for environmental cleanup.

196. The Board believes that the standards it has developed will contribute to meeting the operating performance and stewardship reporting objectives of Federal financial reporting. The cleanup cost standards have not been modified for either of these recommendations.

197. One modification that was made relates to implementation of the standard. Implementation is a significant issue given the magnitude of the Government's existing facilities and its obligations for cleanup of those facilities. One Board member requested that the implementation guidance related to cleanup of general PP&E provide an alternative method. It was suggested that provision of a second method would lower the cost of implementing the standard in situations where the related PP&E had been in service for a substantial portion of its estimated useful life.

198. The second method would be to recognize the entire estimated total cleanup cost as a liability upon implementation. In periods following implementation, entities electing this method would recognize any changes in the estimated total cleanup cost as expense for that period in lieu of the pro-rata amount of the estimated total cleanup cost. This method could be applied only by entities not seeking to recover their costs through user charges.

199. The Board adopted this recommendation in light of the large number of Federal facilities that will be affected by this standard and the cost of implementing the standard.

Appendix B: Illustrations Of Categories

200. In developing categories for Federal mission PP&E, Heritage Assets and Stewardship Land (See paragraphs 46, 57, and 66), the Board sought input from Federal agencies, the Standard General Ledger Issues Resolution Committee (SGLIRC), and other subgroup members. The Board found that there were many cases where similar assets could fit more than one category.

201. For example, aircraft and ships are used by law enforcement agencies as well as by the Department of Defense. Under the proposed categories, only those used by the Department of Defense would meet the criteria for Federal mission PP&E. The illustrations provided are intended to clarify the application of the categories to actual assets.

Illustration 1: Federal Mission Property, Plant, And Equipment

202-213 ... [The category Federal Mission, property, plant, and equipment was rescinded by SFFAS 23, par. 9][81]

Illustration 2: Heritage Assets

214. Many assets are clearly heritage assets. For example, the National Park Service manages the Washington Monument, the Lincoln Memorial and the Mall. However, other assets, particularly Federal office buildings, have historical, cultural or architectural significance as well as being used for general operations.

215. The Board has found that these multi-use heritage assets should still be categorized as heritage assets. Any costs to maintain the assets themselves should be treated as heritage assets. However, any costs that are operational in nature (e.g., reconfiguring of office space or modernized communications wiring) should be classified as general PP&E. Costs of these types of improvements or renovations would then be capitalized and depreciated—providing useful information for performance measurement.

216. For assets that are used solely for heritage purposes (e.g., the Washington Monument), the Board believes that the cost of operation, maintenance, and other periodic expenses

[81]... [The category Federal Mission, property, plant, and equipment was rescinded by SFFAS 23, par. 9]

combined with deferred maintenance disclosures, are sufficient to assess operating performance. Allocating the cost of heritage assets to accounting periods through depreciation would not enhance the information available for performance assessment.

217. Following are examples of general PP&E that exhibit characteristics of heritage assets.

Illustration 2A: Major Office Building

218. A Federal agency constructed a central office building in 1950 to house its headquarters personnel. The building was subsequently placed on the historical registry but continued to serve as headquarters' office space.

219. Public tours are available and educational exhibits are provided in the hallways. However, public access is restricted to guided tours. The majority of floor space is devoted to offices, meeting rooms, cafeterias, and storage.

220. The building is currently undergoing major renovations. The cost of these renovations should be capitalized and depreciated over their expected useful lives only to the extent that the work is tied to operations rather than to preserving the building. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

Illustration 2B: New Office Building

221. A Federal facility previously used for industrial purposes (e.g., production of equipment parts) is being renovated and remodeled to serve as office space. The brick facade is being preserved because of its historic significance. Office space is being constructed inside of the brick facade.

222. The building can be viewed by visitors to the Federal facility, however, access to the office space will be restricted.

223. The original cost of the brick facade should not be included in the cost of the new office building. The cost of new construction should be capitalized and depreciated as part of general PP&E and none should be treated as a heritage asset. Additional information on the heritage nature of the existing brick facade, if material, would be provided through stewardship reporting.

Illustration 2C: Library Of Congress

224. The Library of Congress is undergoing restoration and renovation. This includes:

- restoring artwork and architectural features,
- installing wiring for workstations, and
- building office space.

225. Expenditures for restoration of heritage aspects of the buildings should be treated as a period cost for heritage assets. However, expenditures for operational aspects of the renovation should be categorized as general PP&E. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

Illustration 3: Land

226. The proposed standard provides that land acquired for or in connection with other general PP&E be included in that category. For example, the cost of land on which facilities are located would be included in general PP&E. Other land would be subject to stewardship reporting.

227. The following illustrations cover two potential issues associated with land. First, identifying land associated with general PP&E. Second, identifying land improvements as general PP&E or PP&E subject to stewardship reporting.

Illustration 3A: Military Uses Of Land

228. In general, land used for military bases would be considered general PP&E. However, in some cases, land is used by the military as a site for missile silos, testing grounds or firing ranges. Land used for these purposes meets the definition of stewardship land. The Board believes that period-by-period cost information related to holding land for defense purposes is not relevant to assessing operating performance.

Illustration 3B: Roads On Public Lands

229. Public lands have various types of roads to provide access. These types include:

- rough dirt roads created from years of use,
- dirt roads created by non-Federal land users (e.g., oil & gas exploration crews) and then abandoned, and
- roads created by Federal entities to provide access (e.g., gravel & paved roads).

230. Some of these roads are maintained while others merely exist until natural conditions overtake them.

231. Under private sector accounting, permanent improvements to land are included in the cost of land on the balance sheet. Typically, the cost of clearing and establishing the road bed is considered a permanent improvement because, with routine maintenance, it will remain indefinitely. Any pavement or gravel that must be replaced periodically would be considered depreciable PP&E. For a Federal entity, if the road could be categorized as general PP&E this practice would be appropriate since the period-by-period cost of assets is relevant for assessing operating performance.

232. For land subject to stewardship reporting, the cost of establishing the roadbed would be expensed in the year incurred since the land improved by the roadbed is not capitalized on the balance sheet. On the other hand, the paved and gravel roads are general PP&E because they are operational and the period-by-period cost is essential for assessing operating performance. The cost of pavement or gravel would be capitalized and depreciated. Decisions about the quality of the road conditions (e.g., how often roads are repaved) are an element of operating performance and of the cost of providing government services.

Appendix C: Deferred Maintenance Illustration

Par. 233 and the related illustrations were rescinded by SFFAS 42.

Appendix D: Illustration Of Cleanup Cost

234. This appendix illustrates one method of complying with the standards proposed for cleanup costs. The examples shown in this appendix are for illustrative purposes only. There are many types of cleanup that may be accounted for under this proposed standard (e.g., nuclear facilities, landfills, or laboratories). Applying this proposed standard may require consideration of estimated cost components other than those shown here.

235. The computations are based on a formula allocating the estimated total cleanup costs (i.e., the total amount to be spent in the future to accomplish cleanup) to accounting periods. In identifying the amount to be expensed for the period, the formula considers the cumulative amounts:

- of capacity used at the end of the accounting period; and
- recognized as expense in prior accounting periods.

236. The components of the formula are defined below:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[82]
c = total estimated capacity[83]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

237. To calculate the appropriate expense amount, the following formula is used:

$$(a \times b/c) - d = e$$

238. Simply put, the end of period estimated total cleanup cost (a) is multiplied by the percentage of capacity used up at the end of that period (b/c) to arrive at the portion of cleanup cost that has been generated by operations through the end of the period. Theoretically, that amount of expense has been incurred and should be recognized. Amounts recognized as expense in prior periods (d) should be deducted to arrive at the current period expense amount (e). If this is the first period, the deduction for expense recognized in prior periods (d) is zero.

[82] If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[83] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.23

Illustration 1: Hazardous Waste Disposal Site

Operating Assumptions

239. The hazardous waste disposal site will begin accepting waste in 1995. The following assumptions apply:

- the site capacity is 100,000 cubic yards of waste
- it is estimated that the site will accept waste for ten years at an average rate of 10,000 cubic yards per year
- after the site is closed the following cleanup efforts are required by state, local and Federal laws:
  – site closure & sealing
  – thirty year monitoring
  – remediation
- 1995 cost estimates are based on current cost for 1995
- 1996 cost estimates are based on 1996 costs adjusted for inflation at a rate of 1.0%
- 1997 cost estimates are based on current costs for 1997 and include new technology and changes in monitoring requirements

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1995 (Dollars in thousands)

Estimated Total Cleanup Cost[84] based on Current Cost in 1995

1. Site Closure and Sealing Cost:

Facilities for monitoring operations	$100
Sealing site	750
Erosion and control facilities	500

2. Monitoring Cost (for a period of 30 years):

Inspection	3,000
Sampling & Testing	2,250
Maintenance of facilities	300

[84]This estimate includes any costs of any cleanup efforts required during the thirty year cleanup period. While these activities will not occur until the associated PP&E is closed, the costs are estimated at the current cost to conduct similar efforts.

3. Remediation Cost:
   Projected remediation based on statistical studies 500

   TOTAL ESTIMATED CLEANUP COST $7,400

Calculation of Annual Expense and Accrued Liability Amounts

This proposed standard would require that a portion of the estimated total cleanup costs be recognized as an expense and as a liability each period that the site operates. During 1995, the site accepts 15,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,400 x 15,000/100,000) - 0 = e
$7,400 x .15 = e
$1,110 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[85]
c = total estimated capacity[86]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense	$1,110	
Cr. Cleanup liability		$1,110

To recognize estimated cleanup costs.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1996 (Dollars in thousands)

Estimated Total Cleanup Cost based on Current Cost in 1996

[85]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[86]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

1.	Site Closure and Sealing Cost:	
	Facilities for monitoring operations	$ 101
	Sealing site	758
	Erosion and control facilities	505
2.	Monitoring Cost (for a period of 30 years):	
	Inspection	3,030
	Sampling & Testing	2,273
	Maintenance of facilities	303
3.	Remediation Cost:	
	Projected remediation based on statistical studies	505
	TOTAL ESTIMATED CLEANUP COST	$7,475

Calculation of Annual Expense and Accrued Liability Amounts

During 1996, the estimated total cleanup costs were adjusted for inflation of 1.0% and site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,475 x 25,000/100,000) - $1,110 = e
$7,475 x .25 - $1,110 = e
$759 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[87]
c = total estimated capacity[88]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

[87]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[88]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

The following journal entry would be required:

Dr. Cleanup expense $759

Cr. Cleanup liability $759

To recognize estimated cleanup costs.

In addition, the proposed standard would require that any material changes in the estimate due to changes in laws, technology, or cleanup plans be disclosed. However, there is no indication that material changes occurred.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1997 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1997

1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$ 115
Sealing site	740
Erosion and control facilities	500
2. Monitoring Cost (for 30 years):	
Inspection	2,250
Sampling & Testing	1,300
Maintenance of facilities	300
3. Remediation Cost:	
Projected remediation based on statistical studies	400
TOTAL ESTIMATED CLEANUP COST	$5,605

Calculation of Annual Expense and Accrued Liability Amounts

During 1997, a new estimate of total cleanup costs was prepared and the site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d =e
($5,605 x 35,000/100,000) - ($1,110 + 759)= e

$5,605 x .35 - $1,869 = e
$1,962 - $1,869 = e
$ 93 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[89]
c = total estimated capacity[90]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense	$93	
Cr. Cleanup liability		$93

To recognize estimated cleanup costs.

In addition, the proposed standard would require that material changes in estimated cleanup costs be disclosed and that amounts attributable to prior period operations be disclosed. One means of calculating this amount is to segregate the amount recognized as cleanup expense for the current period between "changes in estimated cleanup cost from prior periods" and "current period cleanup cost." These two amounts would be disclosed.

Changes in estimated cleanup costs from prior periods are:

f = (a x b1/c) - d
f = ($5,605 x 25,000/100,000) - ($1,110 + 759)
f = $5,605 x .25 - $1,869
f = $1,401 - $1,869
f = $(468)

[89]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[90]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

where:

a = total cleanup cost estimated as of end of period
b1 = cumulative capacity used at beginning of period[91]
c = total estimated capacity[92]
d = amount previously recognized as expense at beginning of period
f = changes in estimated cleanup cost from prior periods

Current period cleanup costs are:

g = e - f
g = $ 93 - $(468)
g = $ 561

where:

e = cleanup cost recognized in the current period
f = changes in estimated cleanup cost from prior periods
g = current period cleanup costs

SUMMARY:

FINANCIAL STMT.	1995	1996	1997
Operating expense	$1,110	$ 759	$ 93
Liability	$1,110	$1,869	$1,962

Illustration 2: Nuclear Facility Qualifying As General PP&E

Operating Assumptions

240. A nuclear facility was placed in operation in 1981. No recognition of cleanup cost was made under past accounting policy. At the end of 1995, the entity adopts the accounting policies presented in this proposed standard.

[91]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[92]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

The following assumptions apply:

- the entity has an expected useful life of thirty years
- after the site is closed the following cleanup efforts are required by state, local and Federal laws:
  - site closure & sealing
  - thirty year monitoring
  - remediation
- 1995 cost estimates are based on current cost for 1995

RECOGNITION OF LIABILITY AMOUNTS FOR 1995 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1995

1. Site Closure and Sealing Cost:

Facilities for monitoring operations	$1,000
Sealing site	3,000

2. Monitoring Cost (for 30 years):

Inspection	6,000
Sampling & Testing	3,000
Maintenance of facilities	600

3. Remediation Cost:

Projected remediation based on statistical studies	2,000
TOTAL ESTIMATED CLEANUP COST	$15,600

Calculation of Liability Amount To be Recognized Upon Implementation

At the end of 1995, the estimated total cleanup costs was $15,600,000. The following calculations show the amounts that should have been recognized as of the end of 1995 if the proposed standard had been in effect since the facility began operating on October 1, 1980:

(a x b/c) - d = I
($15,600 x 15/30) - $0 = I
$15,600 x .5 - $0 = I
$7,800 = I

where:

a = total cleanup cost estimated as of end of period
b = number of years of operation
c = estimated useful life
d = amount previously recognized as expense-beginning of period
l = liability to be recognized at the end of 1995

Dr. Net Position $7,800

Cr. Cleanup liability $7,800

To recognize estimated cleanup liability.

No expense is recognized in the year of implementation.

SUMMARY:

FINANCIAL STMT.	**1995**
Prior Period Adjustment	$7,800
Liability	$7,800

Appendix E: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

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 periods beginning after September 30, 1997.
Affects	• Paragraph 36(b) affects SFFAS 5, paragraphs 35-42. • Paragraph 53 affects SFFAS 1, paragraph 41. • Paragraphs 90-102 affect SFFAC 2 paragraphs 64, 74, 105, and Appendix 1-G. • Paragraphs 264-269 amend SFFAS 3 paragraphs 69-70, 72, and 74-77.
Affected by	• SFFAS 13 defers the effective date of paragraph 65.2 of SFFAS 7. • SFFAS 20 rescinds paragraph 65.2 and amended paragraphs 107 and 187.1. • SFFAS 21 rescinds paragraph 76. • SFFAS 22 *(rescinded)* affects paragraphs 80 and 97. • SFFAS 27 affects paragraphs 83 through 87. • SFFAS 31 rescinds paragraphs 83-87 and paragraph 370, and amends paragraphs 142 and 276. • SFFAS 32 amends paragraphs 43, 46, 65.1, and 65.3. • SFFAS 33 amends paragraphs 67.1 and 67.2. • SFFAS 53 amends paragraphs 80-82, 91-93, and 95-102. • TB 2002-2. • TB 2017-1. • TB 2020-1.
Related Guidance	• Interpretation 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 (rescinded)* • Interpretation 5, *Recognition by Recipient Entities of Receivable Nonexchange Revenue: An Interpretation of SFFAS 7*

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

[1]As 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.

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.

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., “unexpended 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.

Table of Contents

(Continued From Previous Page)

(Continued From Previous Page)

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.

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. 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

[1]As 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.

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.

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 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

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

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 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—

[3]The 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.

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

Social Security, Medicare (hospital insurance), 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.

Materiality

27. Except as otherwise noted, the provisions of the accounting standards in this statement need not be applied to items that are qualitatively and quantitatively immaterial.

28. 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

29. The provisions of this statement are effective for reporting periods that begin after September 30, 1997. Earlier application is encouraged.

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]

    (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

[5]This 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.

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 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*

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[6]SFFAS 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.

[7]SFFAS 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.

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. The U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned 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 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).

The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements.

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

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

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 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.

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, 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 assessments[10] or pre-assessment work in process.

[9]SFFAS 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.

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

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 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

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

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.

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

[12] Future 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.

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 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

[13]SFFAS No. 1, para. 44-51.

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 assets[14] 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 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. The U.S. government-wide financial statements need not disclose factors affecting collectibility and timing of categories of accounts receivable and the amounts involved.

65.2 [Rescinded by SFFAS 20.]

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

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. The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax 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. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.

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 estimate of additional revenues reasonably expected 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 reasonable 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.

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]

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[15]Other 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.

[16]As 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.

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

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 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]

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.

[18]These 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.

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. To better understand these differences, the reconciliation should explain the relationship between the net cost of operations[18.1] and net outlays by the entity during the reporting period. The reconciliation should reference the reported “net outlays”[18.2] and related adjustments as defined by Office

[18.1]The terms ”net cost of operations” and “net cost” are used interchangeably to refer to the total cost incurred by the reporting entity less exchange revenue earned during the period.

[18.2] OMB Circular A-11: Preparation, Submission, and Execution of the Budget states, "Outlay means a payment to liquidate an obligation (other than the repayment to the Treasury of debt principal). Outlays are a measure of Government spending. Subtract all offsetting collections (unexpired and expired) from gross outlays to yield net outlays so that the contribution of the budget account to the Federal Government's bottom line (the surplus or deficit) can be determined."

of Management and Budget (OMB) Circular A-11: *Preparation, Submission, and Execution of the Budget*

81. The net cost of operations should be adjusted by

    (a) components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);

    (b) components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and

    (c) other temporary timing differences (e.g., prior period adjustments due to correction of errors).

82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis amounts used in financial accounting. A narrative explaining the purpose, the nature, and the line items of the reconciliation also should be presented with the reconciliation. The amount and nature of non-cash outlays should be disclosed. For purposes of this Statement, non-cash outlays are outlays that are recognized without a concurrent cash disbursement, such as interest accrued by the Department of the Treasury (Treasury) on debt held by the public and the change in allowance for subsidy cost.

ACCOUNTABILITY FOR DEDICATED COLLECTIONS

[Paragraphs 83 through 87 were rescinded by SFFAS 31 paragraph 34.]

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. 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 and outlay-based measures used in budgetary reporting.

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 **Budget and Accrual Reconciliation** (BAR) that reconciles the net budgetary outlays 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 **Budget and Accrual Reconciliation** 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 (referencing the Reconciliation of Net Costs to Outlays) should be added stating the following:

> OMB will provide guidance regarding details of the display for the Budget and Accrual Reconciliation, including whether it should 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.”

Budget and Accrual Reconciliation

95. The purpose of the reconciliation of Net Costs to Outlays is to explain how budgetary resources outlayed during the period relate to the net cost of operations for the reporting entity. This information should be presented in a way that clarifies the relationship between the outlays reported through budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship, the reconciliation provides the information necessary to understand how the budgetary outlays finance the net cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the reconciliation are indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from outlays to net cost of operations.

96. **Net Cost of Operations** is from the Statement of Net Cost.

97. **Components of net cost that are not part of net outlays** are most commonly (a) 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), (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period, and (c) costs financed by other entities (imputed inter-entity costs).

98. **Components of net outlays that are not part of net cost** are primarily amounts provided in the current reporting period that fund costs incurred in prior years and amounts incurred for goods or services that have been capitalized on the balance sheet (e.g., plant, property and equipment acquisition and inventory acquisition).

99. **Other temporary timing differences** reflect special adjustments (e.g., prior period adjustments due to correction of errors).

100. **Net Outlays** is the summation of the above amounts and equals the Statement of Budgetary Resources net outlays amount.

101. The preparer should present material amounts separately in the reconciliation and discuss these in the narrative. The use of "other" captions should be minimized and individually material amounts should not be netted to report an immaterial amount.

102. The following is an example for the financial statement format. This format and its narrative will be added to the appendices of SFFAC No. 2.

Entity and Display, Appendix 1-G

EXAMPLE FINANCIAL STATEMENT FORMATS - BUDGET AND ACCURAL RECONCILIAITON

NARRATIVE

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis below illustrates this reconciliation by listing the key differences between net cost and net outlays.

*Unrealized valuation loss on investment in the reconciliation is related to the write down of security investment due to recent market volatility, which did not result in an outlay but did result in a cost. The large increase of accounts payable compared to last year is because this year's rent expense has not been paid but was included in the net cost this year and not included in the outlays. The large variance in the "transfers in/(out) without reimbursement" between fiscal year (FY) 201X and FY201X is primarily due to the transfer of program management responsibility from agency 1 to agency 2 as discussed in further detail in Note X. In addition, the decrease in "Imputed financing source" is a result of the payment in FY201X for the ABC Settlement.**

*This is an illustration of what might be presented in the narrative paragraph. It is an example of how to explain the material line items in the reconciliation and describes why some material line items either increase or decrease net cost but do not have the same impact on net outlays.

RECONCILIATION EXAMPLE- For the year ended September 30, 201X

	Intra-governmental	With the public	Total FY 201x
NET COST	$xxx	$xxx	$xxx
Components of Net Cost That Are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	xxx	xxx	xxx
Property, plant, and equipment disposal & revaluation	xxx	xxx	xxx
Year-end credit reform subsidy re-estimates	xxx	xxx	xxx
Unrealized valuation loss/(gain) on investments---	xxx	xxx	xxx
Increase/(decrease) in assets:			
Accounts receivable	xxx	xxx	xxx
Loans receivable	xxx	xxx	xxx
Investments	xxx	xxx	xxx
Other assets	xxx	xxx	xxx
(Increase)/decrease in liabilities:			
Accounts payable	xxx	xxx	xxx
Salaries and benefits	xxx	xxx	xxx
Insurance and guarantee program liabilities	xxx	xxx	xxx
Environmental and disposal liabilities	xxx	xxx	xxx
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	xxx	xxx	xxx
Other financing sources:			
Federal employee retirement benefit costs paid by OPM and imputed to the agency	xxx	xxx	xxx
Transfers out (in) without reimbursement	xxx	xxx	xxx
Other imputed financing --	xxx	xxx	xxx
Total Components of Net Cost That Are Not Part of Net Outlays	**xxx**	**xxx**	**xxx**
Components of Net Outlays That Are Not Part of Net Cost:			
Effect of prior year agencies credit reform subsidy re-estimates	xxx	xxx	xxx
Acquisition of capital assets	xxx	xxx	xxx
Acquisition of inventory	xxx	xxx	xxx
Acquisition of other assets	xxx	xxx	xxx
Other	xxx	xxx	xxx

	Intra-governmental	With the public	Total FY 201x
Total Components of Net Outlays That Are Not Part of Net Costs	**xxx**	**xxx**	**xxx**
Other Temporary Timing Differences	**xxx**	**xxx**	**xxx**
NET OUTLAYS	**$xxx**	**$xxx**	**$xxx**[18.3]

[18.3] Total Net Outlays can be linked to the Statement of Budgetary Resources, and equals gross outlays less actual offsetting collections and distributed offsetting receipts. The net outlays for Intra-governmental and With the Public listed in the format are calculated totals.

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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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[19]	2	7	**9**
Auditors	10	1	**11**
Preparers	22		**22**
Total	**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

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

with the widening of disclosures about funds, the Board required disclosures and supplementary information about any 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.[20]

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.

[20]Even 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.

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.[21]

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.[22]

116. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, 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 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).[23]

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

[21]SFFAC No. 1, *Objectives of Federal Financial Reporting*, paragraphs 126 and 128.

[22]Ibid., 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.

[23]SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts,* para. 31-40.

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 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.[24] Each responsibility segment must be able to assign full costs to the measurable outputs of its programs.[25] 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.

[24]See ibid., para. 77-88. Also see SFFAC No. 2, Entity and Display, para. 75 and footnote 14.

[25]SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts,* para. 89-104 and 116-143.

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, 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.[26]

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)[27] 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.[28]

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

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

[27]Public Law 103-62.

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

separately (1) the full revenue due 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.[29] For intragovernmental transactions, allowances for bad 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.

[29]Ibid., para. 44-51 and 131-133.

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.

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.[30] 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 and distributes it to the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the

[30]Methods 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.

states, and Indian tribes and allottees. MMS should account for the exchange revenue it collects as an agent for the U.S. Treasury or other federal component entities as a custodial activity, which is an amount collected or to be collected for other federal entities, in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with SFFAS 31, *Accounting for Fiduciary Activities*. 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.

> SFFAS 31, *Accounting for Fiduciary Activities*, amended the provisions in paragraph 142. This amendment is effective for periods ending after September 30, 2008. To view the explanatory text prior to this date, please see the previous edition of the *FASAB Handbook* at https://fasab.gov/accounting-standards/archived-versions/

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 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.

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.[31] However, 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."[32] This generic definition and the accompanying examples in the circular are generally consistent with the definition of "full cost" in the managerial cost accounting standards[33] and the recognition and measurement of many particular expenses in other Federal accounting standards.[34] 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);[35] 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

[31]Circular 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.

[32]Circular A-25, section 6(d)(1).

[33]SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 93-107.

[34]For 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*.

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

few cases may be used in connection with the production of goods or services for sale.[36] Aside from these differences, the cost accounting and other accounting standards should enable the Circular A-25 definition of full cost to be measured more accurately than has been possible heretofore.[37]

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.[38] 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.

[36]The 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*.

[37]Circular 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.

[38]The general principles for recognizing imputed cost are stated in SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts,* 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 returns[39] 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

[39]Even 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.

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 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 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.

Disclosures, Supplementary Information, and Other Accompanying Information

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.[40]

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, 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

[40]Pursuant 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.]

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.[41]

189. Estimates of the tax gap by IRS have been made from time to time. Congress recently concluded not to authorize a current study[42] 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 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

[41]For 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.

[42]The Tax Compliance Measurement Program (TCMP) planned for 1996.

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.

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 under-utilized 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.

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.[43] 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.

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

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.

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.[44] The imputing process recognizes these costs in the net cost of operations of the responsible entity. 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

[44]Imputed 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.

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.

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.

Table of Transactions

(Continued From Previous Page)

Transactions With The Public

Nonexchange transactions with the public

242. Individual income taxes, corporation income taxes, social insurance taxes and contributions,[45] 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 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

[45]"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.

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.[46] 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.

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.

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

246. Social insurance taxes and contributions paid by Federal employees.[47]—Federal employees may be covered by social insurance programs such as Social Security[48] 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 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

[47]"Social insurance" does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

[48]Most Federal civilian employees hired before 1984 are not covered by Social Security.

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.

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.[49] The collections are dedicated by 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. <u>Deposits of earnings, Federal Reserve System</u>.—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.[50] 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.

[49]These fees are sometimes called the "COBRA user fees." This term comes from the Consolidated Omnibus Budget Reconciliation Act of 1985, which established these fees.

[50]SFFAC No. 2, *Entity and Display,* para. 47.

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.[51] 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. 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 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

[51] The term "donations" includes wills disposing of property and judicial proceedings other than forfeitures.

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).[52]

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 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.[53]

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

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

[53]SFFAS 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.

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 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,[54] 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 collects rents, royalties, and bonuses and distributes the collections to 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. MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for Fiduciary Activities*. The amounts of revenue should be recognized and measured under the exchange 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

[54]The 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.

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-1991[55] direct loans.[56]—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. 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.[57]

[55]Post-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.

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

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

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 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.[58]—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 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.[59]

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

[58]Federal employee retirement plans do not include social insurance, such as Social Security and Medicare.8

[59]For 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.

equal to the estimated cost of collecting these duties, including all costs of operations in Puerto Rico 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.

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 price[60] 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.[61]

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.[62] 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.

[60]The sales price may include the fair value of items received in exchange.

[61]SFFAS 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.)

[62]See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 32.

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.[63]

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.[64]

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.

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.[65] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[66]

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

[63]Ibid., footnote 38.

[64]See SFFAS No. 3, *Accounting for Inventory and Related Property*, para. 79-91.

[65]This 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.

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

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.[67]

Other financing sources from the public

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 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.

[67] SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 54.

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.[68]—Federal employees may be covered by social insurance programs such as Social Security[69] 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 classification as private employer contributions, which is nonexchange revenue.

[68]"Social insurance" does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

[69]Most Federal civilian employees hired before 1984 are not covered by Social Security.

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.[70]

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.

[70]For 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.

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.[71] 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.

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

[71]See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 96 and para. 181, footnote 70.

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.

Exchange transactions—intragovernmental: gains and losses

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 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.[72]

[72]See SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts,* para. 105-115.

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.[73] 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.[74] The imputed financing is necessary so that the imputed cost 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.[75]

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

[73]Retired 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.

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

[75]For 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.

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.

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.[76]

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.[77]

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.

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

[76] SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* para. 39.

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

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).[78]

[78]See SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* para. 32.

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.

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.[79]

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.[80] 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.[81]

[79]SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 61 and 72.

[80]Ibid.

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 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.[82]

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.[83]

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.[84]

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

[81]For 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.

[82]The fee component of the subsidy cost is required to be disclosed separately.

[83]If 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.

[84]If 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.

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.[85]

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.[86]Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[87] 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 asset for another of equal recorded value and therefore is not recognized as a gain, a revenue, or an other financing source.[88]

370. [Paragraph 370 was rescinded by SFFAS 31, paragraph 34.]

[85]If 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.

[86]This 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.

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

[88]See 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”.

Index Of Transactions Classified In Appendix B

Interest on delinquent taxes and other receivables that arise as the result of custodial operations (88)
Interest on post-1991 direct loans (87)
Interest on Treasury securities held by revolving funds (97)
Interest on Treasury securities held by trust funds and special funds (except trust revolving funds) (93)
Interest on Treasury securities held by trust revolving funds (97)
Interest on uninvested funds received by direct loan and guaranteed loan financing accounts (98)
Interest received by one fund from another (94)
Interest received by Treasury (98)
Intragovernmental sales of goods and services by a fund other than a revolving fund (95)
Intragovernmental sales of goods and services by a revolving fund (95)
INTRAGOVERNMENTAL TRANSACTIONS (93)
Negative subsidies on post-1991 direct loans and loan guarantees (105)
Nonexchange transactions with the public (78)
Nonexchange transactions-intragovernmental: gains and losses (95)
Nonexchange transactions-intragovernmental: revenue (93)
Other financing sources from the public (93)
Other financing sources-intragovernmental (99)
Penalties due to delinquent taxes in connection with custodial activity (83)
Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance (88)
Proceeds from the auction of the radio spectrum (87)
Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees (88)
Reimbursement for cleanup costs (90)
Reimbursement for collecting revenue (89)
Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights. (98)
Repayment of post-1991 direct loans (106)
Repayment of pre-1992 direct loans (106)
Repayment of receivables: except direct loans (106)
Retirement of debt securities prior to maturity (95)
Retirement of debt securities prior to maturity: revolving funds and trust revolving funds (98)
Retirement of debt securities prior to maturity (92)
Revaluation of capitalized property, plant, and equipment (102)
Revaluation of inventory and related property (103)
REVALUATIONS (102)
Sales of different types of Government assets (104)
Sales of direct loans (92)
Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees (107)
Sales of foreclosed property: associated with pre-1992 direct loans (92)

List of Abbreviations

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

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 6 through 7 are not effective until further action by the Board.
Affects	None.
Affected by	• 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. • SFFAS 57, rescinded SFFAS 8 in its entirety.

SFFAS 57, Omnibus Amendments 2019, rescinded SFFAS 8 in its entirety.

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	November 3, 1997
Effective Date	For fiscal years ending September 30, 1998 and thereafter.
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.

Table Of Contents

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 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

[1]In 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.

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

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

[4]The 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.

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 Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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	October 9, 1998
Effective Date	For periods beginning after September 30, 2000
Affects	• SFFAS 10, paragraph 7, rescinds SFFAS 6, paragraphs 27-28.
Affected by	• SFFAS 32 amends paragraph 35. • SFFAS 50 amends paragraph 16 and 36.
Related Guidance	TR 16, *Implementation Guidance for Internal Use Software*.

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.

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.

Table Of Contents

Introduction

Purpose

1. This statement provides accounting standards for internal use software[1] 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.

[1]The 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 phases[2] 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.

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.

[2]There 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 CPA'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).

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 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.

[3]See 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."

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

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. Although the measurement basis remains historical cost, reasonable estimates maybe used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein. 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).

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

[6]For 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*.

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 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]

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[7]However, 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.

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:

    - 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.
    - 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;

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

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 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.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. government-wide financial statements for these activities.

[9]For 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.

Implementation

36. Alternative Methods for Establishing Opening Balances.[9A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or the line item addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

   a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[9B] that its financial statements, or the line item addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

   b. The application of these alternative methods based on the second condition specified in paragraph 36 is available only once to each reporting entity.

   c. A reporting entity that meets either condition in paragraph 36 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

   d. Alternative Methods. A reporting entity should choose among the following alternative methods for establishing an opening balance for internal use software. Because a reporting entity may have multiple component or subcomponent reporting entities[9C]

[9A] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[9B] An unreserved assertion is an unconditional statement.

[9C] SFFAS 47, *Reporting Entity*, provides that “component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

i. Alternative Valuation Method. Deemed cost[9D] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40.d. for implementation guidance regarding deemed cost.

ii. Prospective capitalization. The reporting entity may choose prospective capitalization of internal use software. If the reporting entity elects prospective treatment, the reporting entity should choose between the following acceptable alternative methods at the opening balance date:

(a) Exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance.

(b) Exclude internal use software in service from the opening balance, but include amounts related to internal use software under development at the opening balance date. Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 through 27 or on the alternative valuation method (deemed cost) provided in paragraph 36.d.i.

e. Once established using alternative methods, opening balances are considered consistent with GAAP.

f. Component Reporting Entity Disclosures:

i. A component reporting entity electing to apply deemed cost in establishing opening balances for internal use software should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No

[9D] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 36.d.ii. should disclose this fact and describe the alternative methods used in the first reporting period in which the component reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternative methods are applied by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which the alternative method was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of internal use software included in the opening balance is required.

g. Financial Report of the U.S. Government Disclosures:

i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

ii. When a component reporting entity elects to apply the provisions of paragraph 36.d.ii.,the U.S. government-wide financial statements should disclose this fact, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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.

[10] See SFFAS No. 6, par. 17.

40. Regarding any costs of internal use software acquired or developed for stewardship PP&E or stewardship investments, the Board chose to 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.

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

[11]Par. 37.

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 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]

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[12]Also, 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."

[13]See 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.

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 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

[14]SFFAS No. 4, par. 143.

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 new federal capital programming guidelines[15] 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.

[15]The 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).

[17]Published 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*.

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.

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 concepts[19] 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.

[19]See 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.

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 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.

[20]See 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.

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.

Appendix B: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

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 (Rescinded)

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. As of September 30, 2002 this statement was rescinded in its entirely by SFFAS 23.
Affects	None.
Affected by	• SFFAS 23 rescinded SFFAS 11 in its entirety.

SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment* rescinded 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	February 5, 1999
Effective Date	For periods beginning after September 30, 1997
Affects	SFFAS 5, paragraphs 33 and 36.
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 recognized[1] 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, disclosure[2] 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.

[1]The 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

[2]The 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.

Table Of Contents

Purpose

1. This Statement amends Statement of Federal Financial Accounting Standards Number 5 (SFFAS No. 5), A*ccounting 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.[1] 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.[2] 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.[3]

5. SFFAS No. 5 uses the same general framework for evaluating loss contingencies as Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards

[1]SFFAS No. 5, par. 35, and also in Appendix C.

[2]SFFAS No.5, par. 36.

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

No. 5, *Accounting for Contingencies* (SFAS No. 5). Contingencies can be “probable,” “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.”[4]

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.

[4]SFFAS 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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 statements.

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.

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	February 5, 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.
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.

Table Of Contents

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 (Rescinded)

Status

Issued	June 8, 1999
Effective Date	For fiscal years beginning after September 30, 1998 with earlier implementation encouraged.
Affects	• SFFAS 6 paragraphs 79-80 and 83-84.
Affected by	• SFFAS 29, par. 13 rescinds par. 10 and 11 of SFFAS 14. • SFFAS 42 rescinded SFFAS 14 in its entirety.

SFFAS 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32* rescinded SFFAS 14 in its entirety.

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

Status

Issued	August 12, 1999
Effective Date	For fiscal periods beginning after September 30, 1999
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 Standards* published by

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[1]The 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.

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.

Table Of Contents

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 <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the

[2]See 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
    - 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.

[3]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. 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.*

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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

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

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 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 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.

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

[6]The 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.

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 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

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

[8]Accountability 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.)

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 (Rescinded)

Status

Issued	September 8, 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Affects	None.
Affected by	• 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, *Heritage Assets and Stewardship Land* par. 14 rescinded SFFAS 16 in its entirety.

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

Status

Issued	November 19, 1999
Effective Date	For fiscal periods beginning after September 30, 1999
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. • SFFAS 33, par. 39-41, affects SFFAS 17, par. 25, 27(2), and 27(4)(a). • SFFAS 37 affects SFFAS 17, par. 26, 26A, 27, and 32.

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:

(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 of no influence, also are important to achieving the goals implied by these objectives. [par. 36]

Table Of Contents

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.

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.

[1]See 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.

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]

   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

[2] SFFAC No. 1, par. 109.

[3] SFFAC No. 1, par. 122.

(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 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:

[4]SFFAC No. 1, par. 134.

(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
- 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.

[5] The 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.

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 reasonable 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 by this Statement 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. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

26.A. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from estimated cost. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate. For example:

> APPLICATION OF CRITICAL ACCOUNTING ESTIMATES
>
> The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

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:

Actuarial projections of the annual cashflow, 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.

For the OASDI and HI programs, the actuarial projections of the annual cash-flows should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

(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.,

[6]“Interest on intragovernmental borrowing” refers to interest earned by the social insurance program on obligations of the U.S. Government.

75 years), using the program managers' estimate.[7] 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;[8]

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),

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[7]SMI, 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."

[8]A 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 a in 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.

(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.

<u>Net present value of cashflow during the projection period:</u>

(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).

<u>Notes to the statement should present:</u>

(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 behalf 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) <u>*Sensitivity Analysis*</u> -

All programs should provide sensitivity analysis appropriate for their particular circumstances. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The OASDI, Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure presented in the SOSI summary. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. The entity should state that the amounts of the closed and open group measure depend on the assumptions used and that actual experience is likely to differ from the estimate.

(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

> SFFAS 26 reclassified most RSSI as RSI. See SFFAS 26 for detailed guidance.

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.

(4) *Sensitivity Analysis* - For all social insurance programs provide a summary of the sensitivity analyses required for component entities.

(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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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	2 [retired employees]	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.

Expanded Presentation and Visibility of Actuarial Present Values

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 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.

Specific Identification of Social Insurance Programs

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.

Consistency of Assumptions

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 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.[9]

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 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.

[9]SFFAC No. 1, *Objectives of Federal Financial Reporting*, pars. 52, 53, 55, and 60.

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.[10]

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.

[10]SFFAS No. 5, pars. 129-131.

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 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.[11]

[11]See 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).

Uncertainty

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 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.

Measurement of Social Insurance Obligations

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 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 be 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 liability[12] 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 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.”

[12][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]

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.[13]

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.

[13]Budget issues: Budgeting for Federal Insurance Programs, General Accounting Office, GAO/AIMD-97-16, Sept. 30, 1997, p. 5.

Transition Costs

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.[14] 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 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.”

[14]Several 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.

> 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.[15] 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:

> ... 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.[16]

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

[15]Note 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.

[16]Statement 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.

> 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.[17]

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 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.[18]

. . .

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

[17]Greenspan, p. 4-5.

[18]Greenspan, p. 9.

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]

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.[19] The trust fund ratio is one of several measures the Social Security

[19] The 1997 Annual Report of The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 221.

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.[20] The Council believed that the trend of trust fund ratio would indicate 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.

[20]See *Findings and Recommendations*, vol. 1, p. 17 (Jan. 1997).

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.

<u>Social Security</u> - 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**
Actuarial present value of future benefit payments[b] during the 75-year period to or on behalf of:					
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**
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:					
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
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period [d]	**$3**	**$X**	**$X**	**$X**	**$Y**

Notes to the Statement:

[a]The 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 a in 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.

[c]To 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.

[d]The 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.

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;

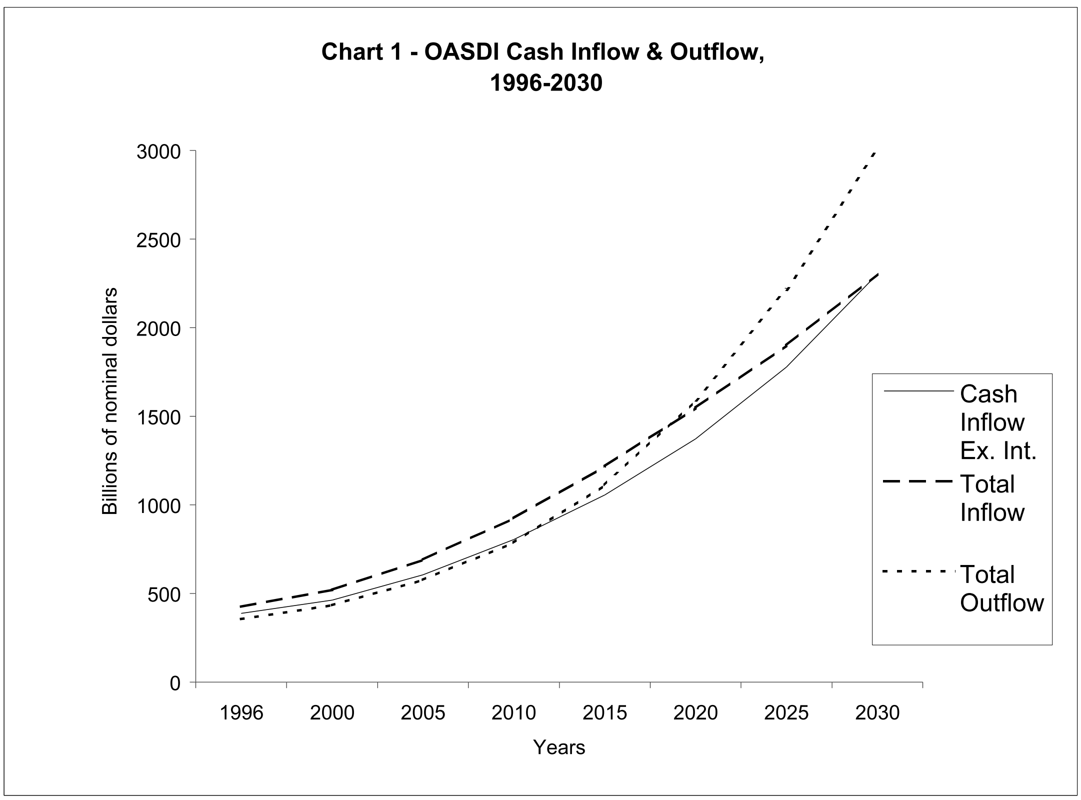
(3) the ratio of contributors to beneficiaries or "dependency ratio" showing the long-range relationship between the program's beneficiaries and contributors; and

(4) an analysis of the sensitivity of the projections to changes in assumptions.

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.[21] 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.



Source: Data from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

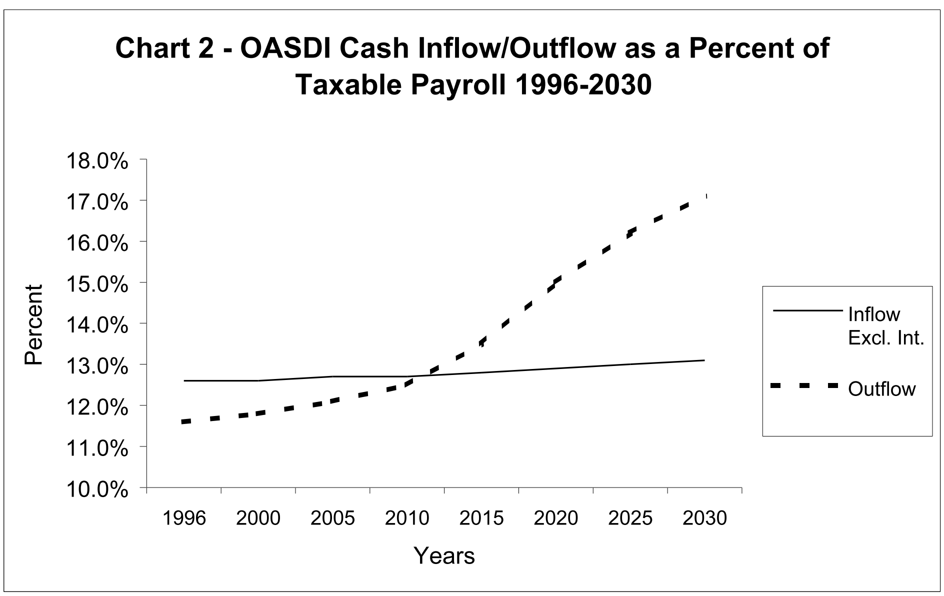
[21][Please note: the standard does not require information on the year when the assets would be exhausted as the program is currently structured (see par. 117). This information illustrates that management can provide data in addition to that required by the standard where it feels doing so would be useful to readers of the report.]

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.



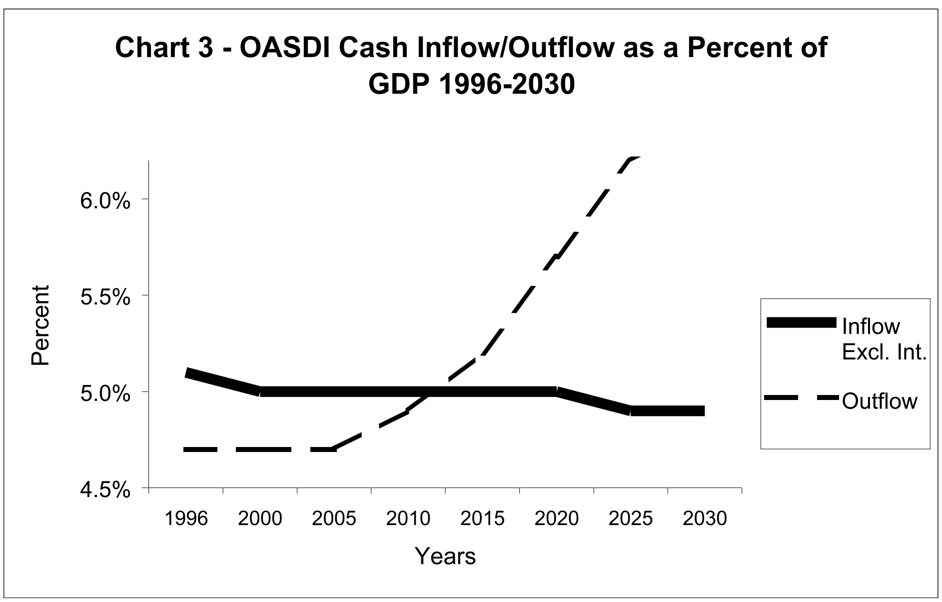
Source: Data from Tables III A2, 1996 OASDI Trustee's Report.

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.[22] There would be trust fund surpluses in the early 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

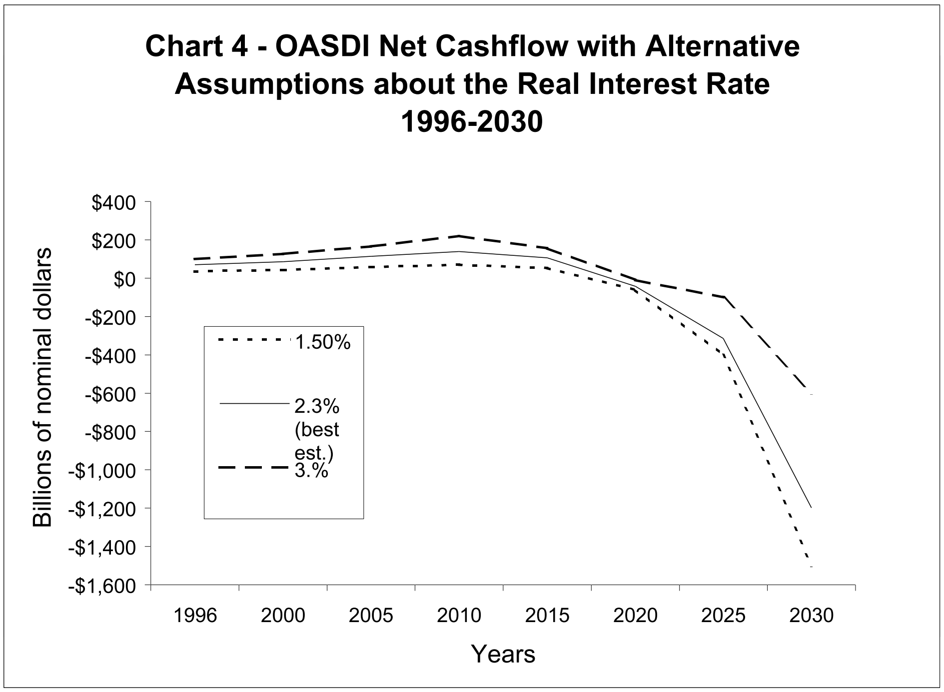
[22][Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 2.]

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.

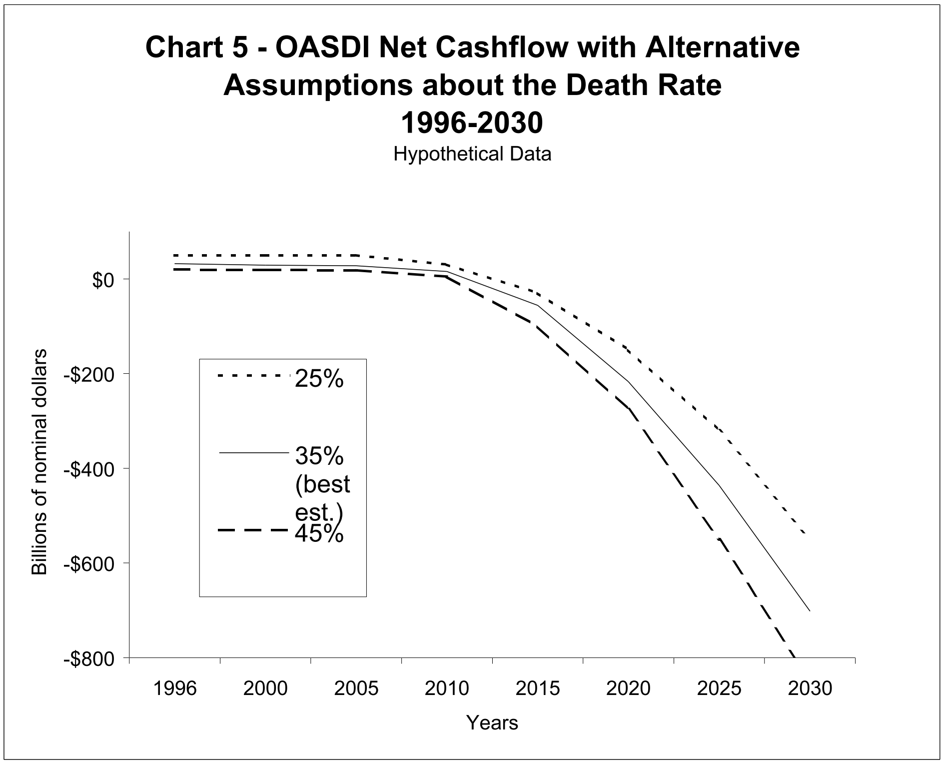
125. *Real Interest Rate* - The “best estimate” long-range cashflow projections presented in Chart 1 above assume a 4 percent increase in Consumer Price Index (CPI) per year after the year 2000 as the inflation rate and a 2.3 percent real interest rate. The “real interest rate” is the difference between 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.

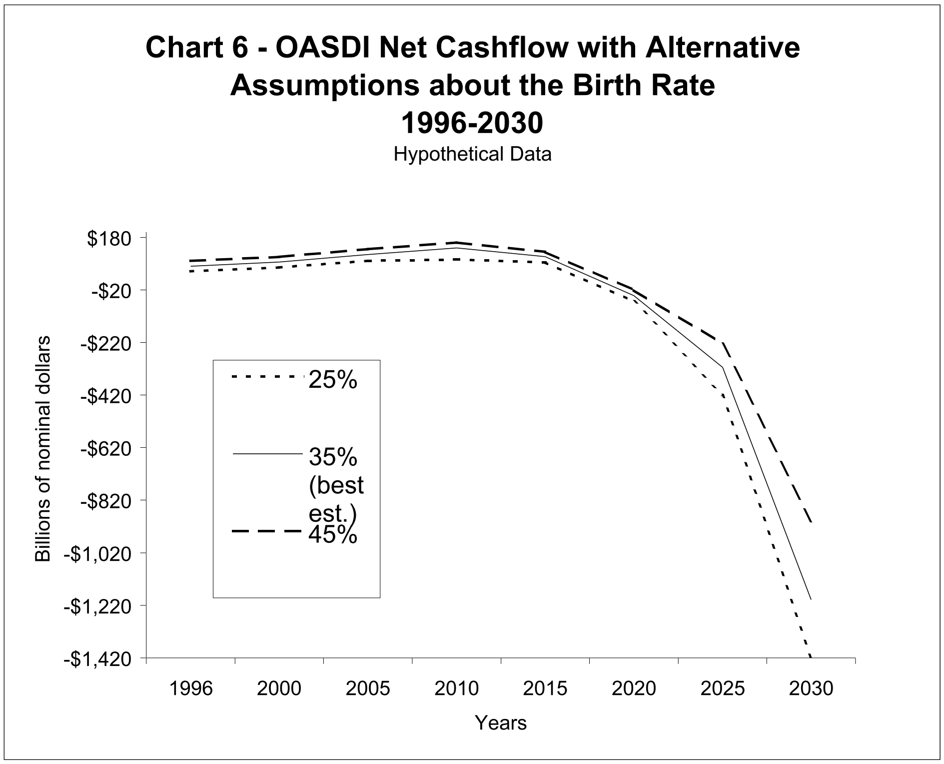


Source: Data regarding “best estimate” is from Tables III B1, B3, & C1, 1996 OASDI Trustee’s Report.

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.



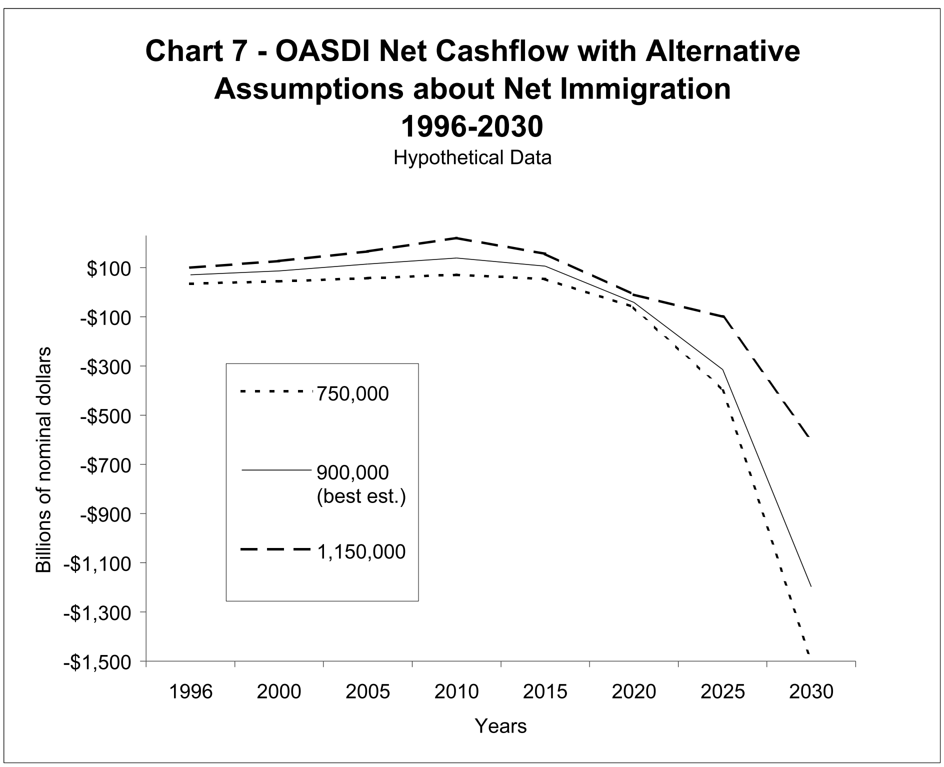
Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

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

Dollars in trillions			
	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	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.

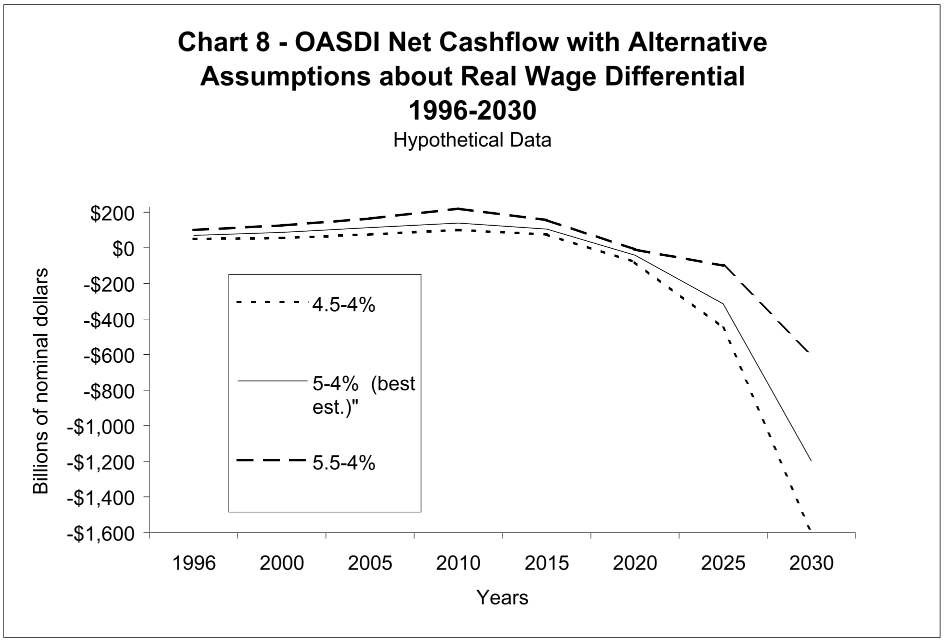
Regarding actuarial present values over 75 years, table 2 below shows the estimated total excess of OASDI cash outflow over inflow with assumptions that differ from those used for the “best estimate” projection.

Table 2: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Net Immigration Assumptions - Valuation Period: 1996-2070

Dollars in trillions

	Net immigration per year		
Valuation Period: 1996-2070	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.



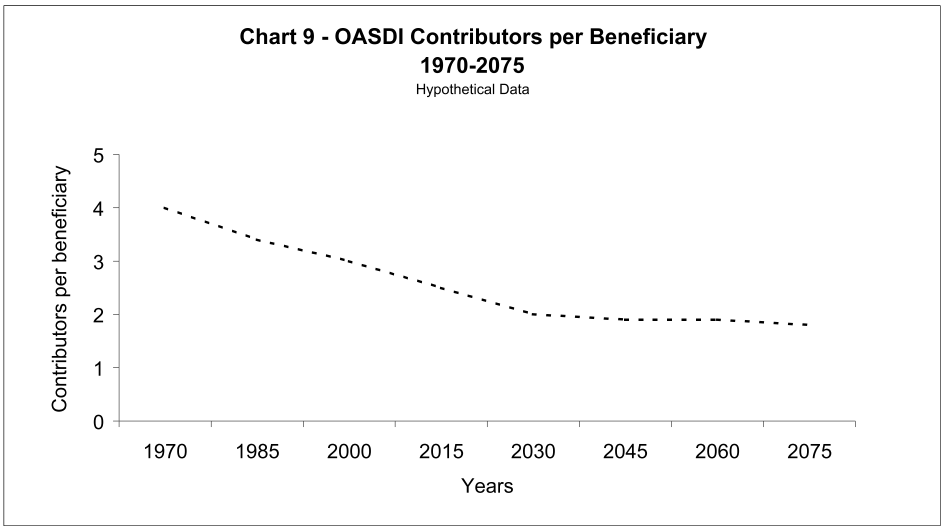
Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

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			
	Ultimate percentage in wages-CPI *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.]*		
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 GDP	Wages	CPI	Ave. Annl. Interest Rate on Treasury Secur. (%)	Ave. Annl. Unempl. Rate	Ave. no. of children per woman	Death rate per 100,000	Life expectancy 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.

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

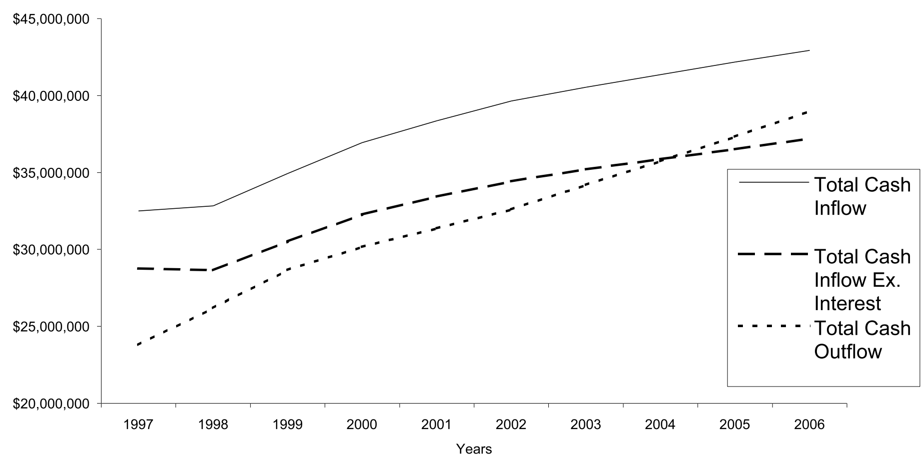
150. At September 30, 1996, total assets within the UTF exceeded liabilities by $54.0 billion.[23] This fund balance approximates the accumulated surplus of tax revenues and earnings on these revenues over benefit payment expenses and is available to finance benefit payments in future periods when tax 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 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.

[23][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.]

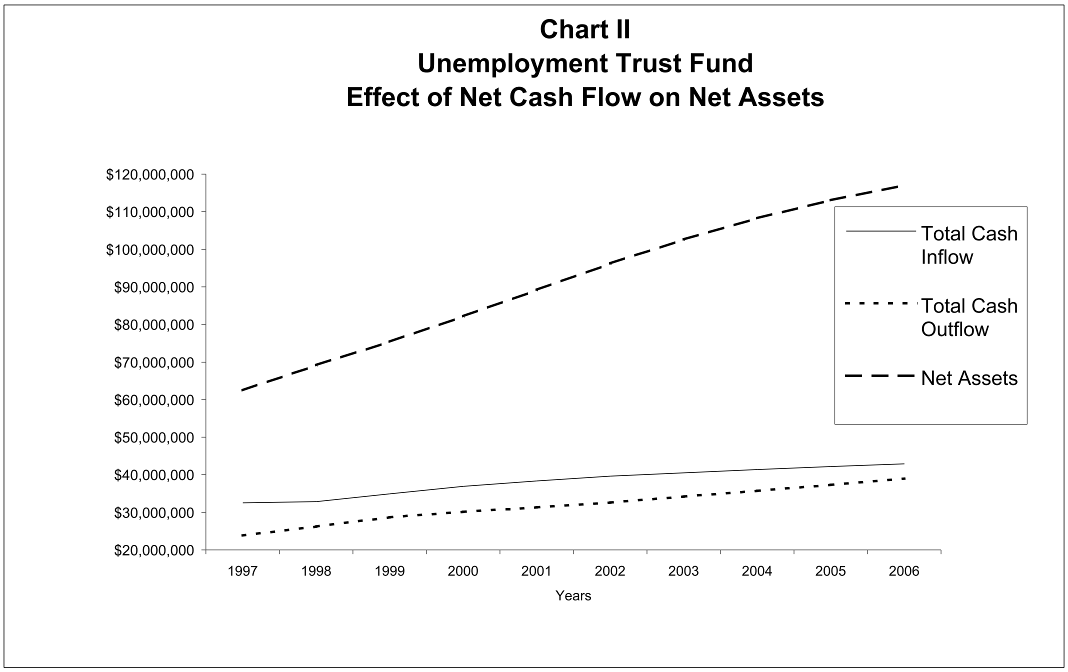
152. *Projected Cash Inflows and Outflows Under Expected Economic Conditions* - Chart I depicts projected cash inflow and outflow of the UTF over the next 10 years, under expected economic conditions. Total cash inflow as well as cash inflow excluding interest earnings is displayed. DOL's current estimates 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.

Chart I
Unemployment Trust Fund
Cash Inflow and Outflow

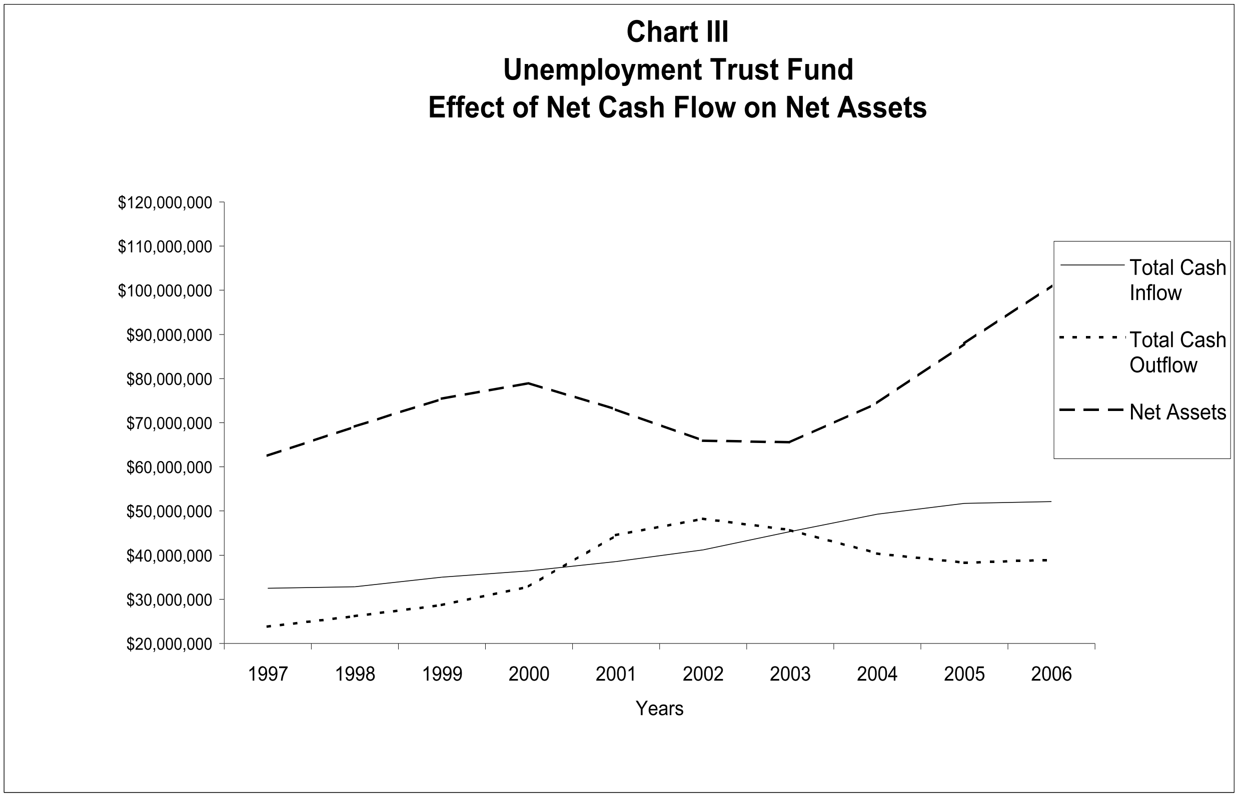


153. *Effect of Expected Cashflows on UTF Assets* - Chart II demonstrates the effect of the expected cash inflow and outflow on the net assets of the UTF over the 10-year period ending September 30, 2006. Yearly projected total cash inflows, including interest earnings, and cash outflows are depicted, 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.



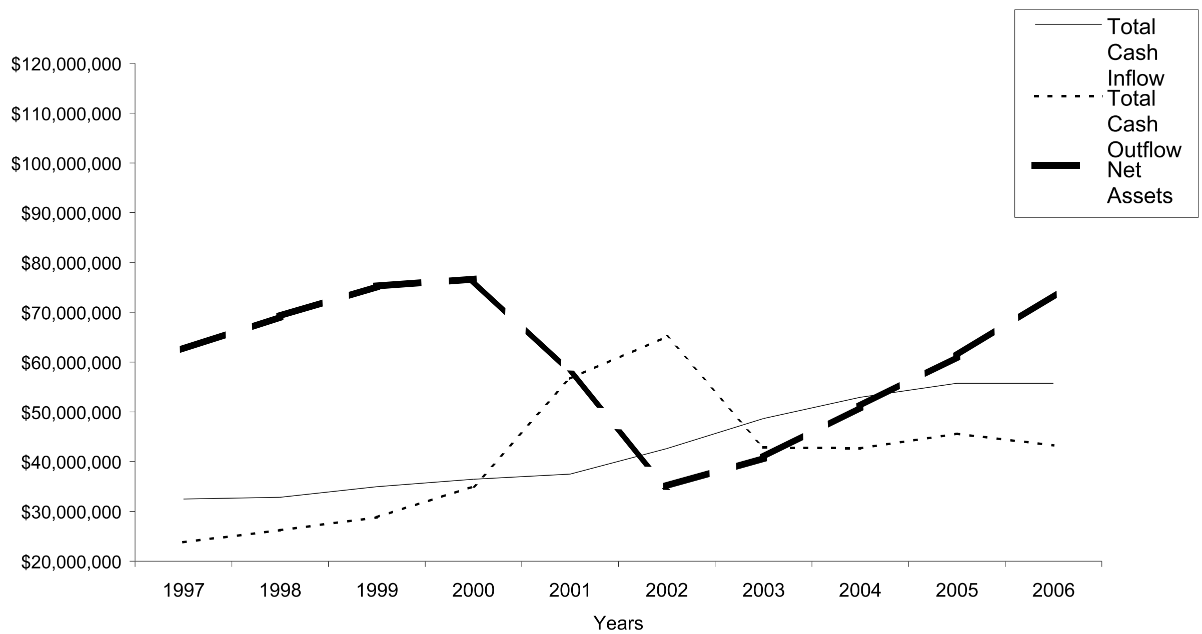
155. *Effect on UTF Assets of Mild Recession* - Chart III shows the projected effects of moderate recession on the cash inflow and outflow of the UTF. Under this scenario, which utilizes a rising unemployment rate peaking at 7.4 percent in FY 2002, net cash outflows are projected to begin in FY 2001, 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 borrows 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.

Chart IV
Unemployment Trust Fund
Effect of Net Cash Flow on Net Assets



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
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

(Continued From Previous Page)

Minimally Solvent		Not Minimally Solvent	
State	**Ratio**	**State**	**Ratio**
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					
			Prior Years		
	1996	**1995**	**1994**	**1993**	**1992**
Actuarial present value of future benefit payments[b] during the 75-year period to or on behalf of:					
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
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:					
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]
Current participants who have attained retirement age[c]	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]

(Continued From Previous Page)

Dollars in Trillions

	Prior Years				
	1996	1995	1994	1993	1992
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
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period [d]	**$X**	**$X**	**$X**	**$X**	**$X**

Notes to the Statement:

[a]The 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 a in 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.

[c] 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 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.

[d]The 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_1 trillion. The fund balances for 1995-2, in trillions, were $$X_2$, X_3, X_4, X_5, 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.

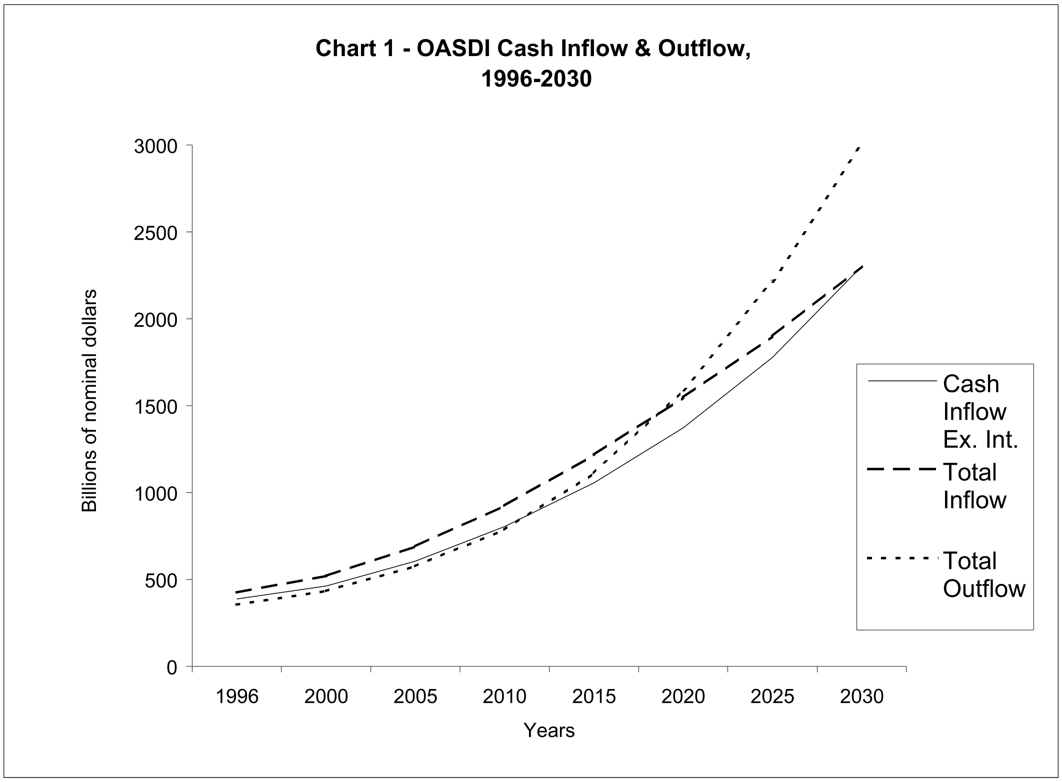
162. While no liability has been recognized on the balance sheet for future payments beyond the amount due as of September 30, actuarial estimates of future program activities have been prepared for the social insurance programs. Long-term actuarial views are a critical element in assessing the financial 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.

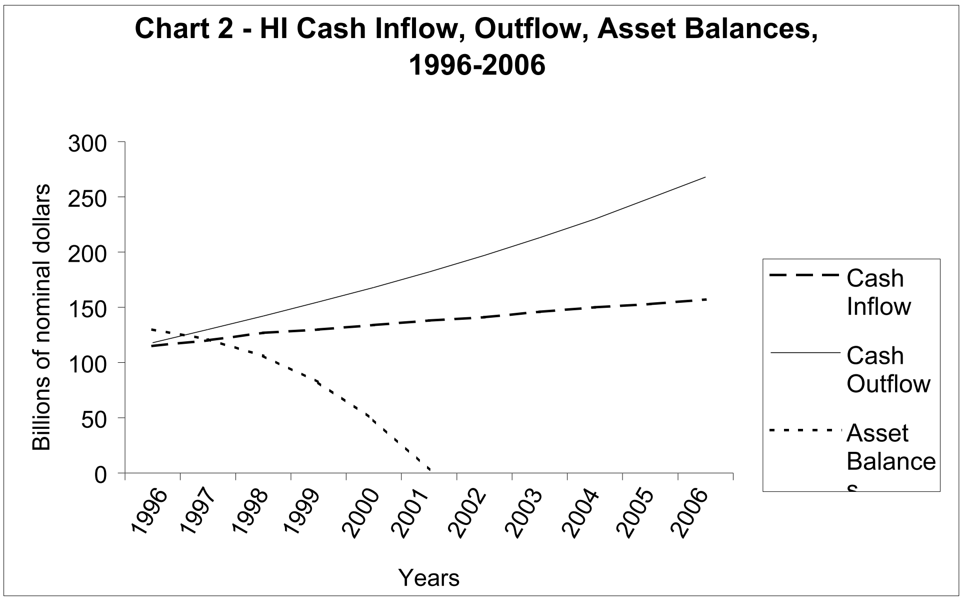
164. The actuarial present values and projections presented here for Social Security and Medicare, which are by far the largest social insurance programs, use the best estimate of the programs' actuaries of future costs over periods ranging up to 75 years. Estimates extending so far into the future, 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.

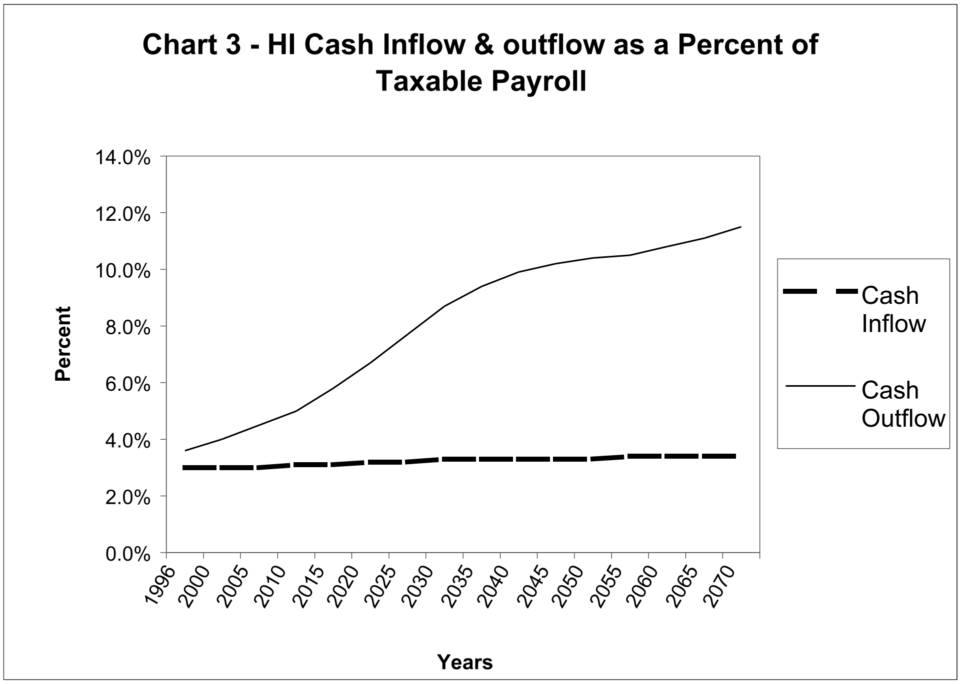


Source: Data from Table II D3, 1997 HI Trustee's Report.

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.



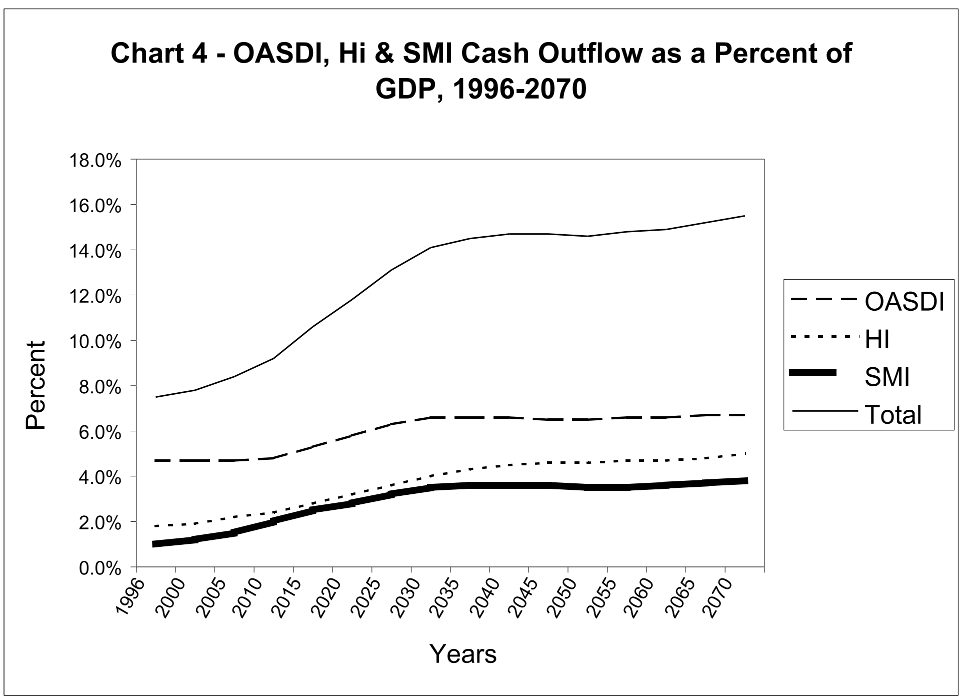
Source: Data from Table II A.2, 1997 OASDI Trustee's Report.

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.[24] 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.



Source: Data from Table III C1, 1996 OASDI Trustee's Report and Table III B1, 1997 HI Trustee's Report.

[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 3.]

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.

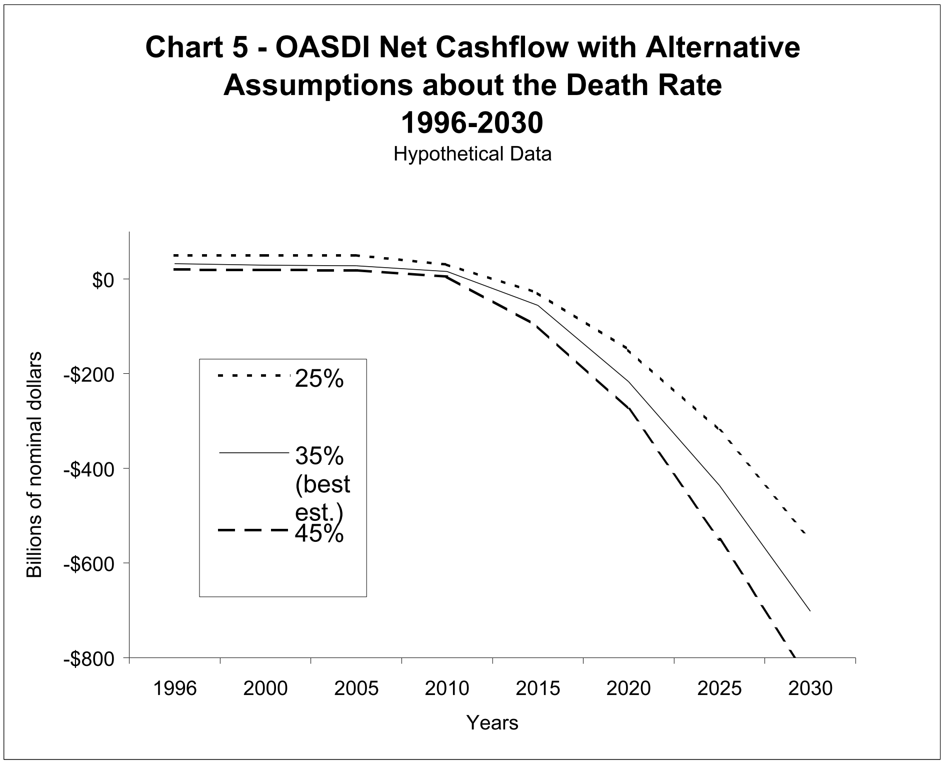
174. ***Sensitivity Analysis***[25] - The future cashflow of the OASDI, Medicare, and other social insurance programs depends on many economic and demographic assumptions. Precise long-range projections of these factors is impossible.

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

[25][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.]

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

Dollars in trillions

	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	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

Dollars in trillions

	Net immigration per year		
Valuation Period: 1996-2070	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.

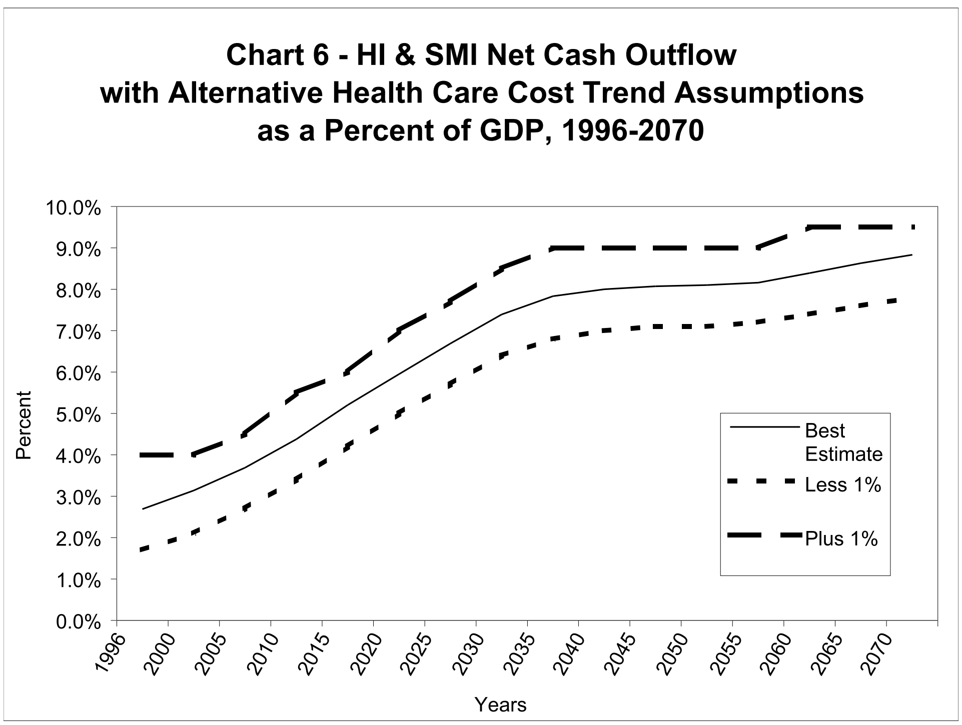
Table 3- Estimated OASDI Actuarial Balances with Various Real-Wage Assumptions - Valuation Period: 1996-2070

Dollars in trillions

	Ultimate percentage in wages-CPI[a]		
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

[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),[26] “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 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

[26] “Closed group” will be used synonymously with “closed group (to new entrants).”

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:

- 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.[27] In early 1997, the Board began again to deliberate the issues. The standard is a product of this project.

[27]SFFAS 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.”

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 17, 2000
Effective Date	For fiscal periods beginning after September 30, 2000.
Affects	• SFFAS 2
Affected by	• SFFAS 19 • SFFAS 32 amends paragraphs 10 and 11.
Related Guidance	• TR 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* • TR 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*

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.

Table Of Contents

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 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

[1]The 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.

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 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.

[2] The 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.

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. The U.S. government-wide financial statements need not disclose a reconciliation between the beginning and ending balances of the subsidy cost allowance for the outstanding direct loans and the liability for outstanding loan guarantees reported in the U.S. government-wide financial statements.

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.

The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 later 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.

[3]See 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.

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 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.

[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]

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 complied 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 an 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

[5]See Statement of Recommended Accounting Standards No. 15, *Management Discussion and Analysis*, (April 1999) par. 18.

already needs to test the reliability of the estimates and reestimates in the context of auditing the basic program subsidy data[6], 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 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

[6]For 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.

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.”

Appendix D: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary.”

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 20, 2001
Effective Date	For periods beginning September 30, 2002
Affects	• SFFAS 2 • SFFAS 18
Affected by	None.
Related Guidance	• TR 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* • TR 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*

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.

Table of Contents

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.

   (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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 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

[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.

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. 18[2] 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.

[2]SFFAS No. 18 amended paragraph 32 in SFFAS No. 2.

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 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.

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 value[3] of the loans over their post-modification value[4]. 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**).

[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).

[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).

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 transfer[5] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

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 liability[6] of the loan guarantees over their pre-modification liability[7]. 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**).

[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.)

[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).

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 modification adjustment transfer[8] 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 transfer[10]

[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".

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 lose related to the modification.

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 29, 2001
Effective Date	For periods beginning after September 30, 2000
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 marjority 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.

Table of Contents

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 receivable[2] 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 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

[2]Per 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.

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 Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources

Status

Issued	October 16, 2001
Effective Date	For periods beginning after September 30, 2001
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.

Table of Contents

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.

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

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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 (Rescinded)

Status

Issued	October 22, 2001
Effective Date	For periods beginning after September 30, 2000
Affects	• SFFAS 7
Affected by	• SFFAS 53 rescinded SFFAS 22 in its entirety.

Summary

SFFAS 53, *Budget and Accrual Reconciliation: Amending SFFAS 7, and 24, and Rescinding SFFAS 22* rescinded SFFAS 22 in its entirety.

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.
Affects	• SFFAS 6, *Accounting for Property, Plant and Equipment* (for additional PP&E discussion and cleanup cost standards) • SFFAS 8, *Supplemental Stewardship Reporting* (Rescinds the prefatory box preceding paragraph 52 of SFFAS 8 and paragraphs 52 through 70 of SFFAS 8.)
Affected by	• SFFAS 35 amends paragraphs 10, 12, 13, 15, 16 and footnote 5 • SFFAS 35 adds paragraph 13A and footnote 4A • SFFAS 35 rescinds paragraphs 11, 17, 18 and footnote 6 • SFFAS 50 amends par. 10 and rescinds par. 11-18.

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.

Table of Contents

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&E[1] were recognized[2] 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;

   c. the dollar values for ND PP&E withdrawn 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.

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.

Accounting Standards

Amendments to Existing Standards

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.

9. The amendments affect existing standards, for periods beginning after September 30, 2002 or upon early implementation of this Statement, in the following manner:

   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:

      - A composite or group depreciation methodology[4], whereby the costs of PP&E are allocated using the same allocation rate, is permissible.

[4] 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. 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.

Implementation Guidance

Initial Capitalization

10. See SFFAS 6 for implementation guidance applicable to all general PP&E.

[Paragraph 11-18 were rescinded by SFFAS 50.][5]

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

[5] Footnote 5 was rescinded by SFFAS 50.

Appendix A: Basis For Conclusions

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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),[6] 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 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.

[6] 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.

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 Item[7];

    b. condition assessment information for Major End Items; and,

[7] 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.

c. actual and planned acquisition program costs and unit information for the ten largest current national defense PP&E[8] 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.

    b. Unit and condition information has been determined to be "sensitive" information[9].

    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.

[8]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."

[9]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.

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.

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.

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.

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 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.

Effective Date

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 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 27, 2003
Effective Date	For periods beginning after September 30, 2001
Affects	None.
Affected by	SFFAS 53, *Amending Inter-entity Cost Provisions*, amends paragraph 9

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.

Table of Contents

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. Paragraphs 77-82 of SFFAS 7 are not applicable to the consolidated financial report of the U.S. Government as a whole.[1]

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:
    - The components of net operating revenue (or cost) that are not part of the unified budget surplus (or deficit), including the 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.

[1]Footnote rescinded by SFFAS 53.

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

A1. 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

A2. 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.

A3. 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

A4. 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,

[2] This category includes professional organizations, academics, and private citizens.

[3] SFFAC 1, fn. 2-3, and par. 212.

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]

A5. 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 entities[5], 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.

A6. 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.

Consolidated Financial Report Exemption from Requirements to Report Certain Budgetary Information

A7. 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

[4] SFFAC 2, par. 38.

[5] SFFAS 1, par. 14.

[6] SFFAS 8, par. 38-39.

[7] *FASAB News*, Jan.-March 2000, p. 2.

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.

A8. 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]

A9. 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 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]

[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.

[11] SFFAS 7, par. 24.

[12] SFFAS 1, par. 31.

A10. 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]

A11. 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.

The Government as a Whole Should Provide Information about Net Operating Revenue (or Cost), the Budget Surplus (or Deficit), and Cash

A12. The information now required in two new statements serves the basic objectives of federal accounting. Objective 1[15] 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.

A13. 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.

A14. 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]

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[13] SFFAS 7, par. 25.

[14] SFFAS 7, par. 26.

[15] SFFAC 1, pars. 112, 119.

[16] SFFAC 7, par. 80.

A15. 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.

A16. 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 the two systems as reconciling items while moving from the proprietary amount to the unified budget surplus or deficit.

A17. 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.

A18. 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.

A19. 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 alternatives 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.

A20. 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.

A21. 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.

A22. 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.

A23. 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.

A24. 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.

A25. 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.

A26. 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

A27. 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)		
[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]		
	FY 20X2	FY 20X1
Net operating revenue or (cost)	46.0	(50.0)
Components of net operating revenue (or cost) not part of the of the budget surplus:		
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
Components of the budget surplus that are not part of net operating		
revenue (or cost):		
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)
Other:		
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]		
[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]		
	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		
Inflows:		
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
Outflows:		
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 Budgetary	20x2 Non-Budgetary Credit Program Financing Accounts	20x1 Budgetary	20x1 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	$ x,xxx	$ x,xxx	$ x,xxx	$ x,xxx

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 Budgetary	20x2 Non-Budgetary Credit Program Financing Accounts	20x1 Budgetary	20x1 Non-Budgetary Credit Program Financing Accounts
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	x,xxx	x,xxx	x,xxx	x,xxx
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	$ x,xxx	$ x,xxx	$ x,xxx	$ x,xxx

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
Resources Used to Finance Activities:		
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. *Total resources used to finance activities*	x,xxx	x,xxx
Resources Used to Finance Items not Part of the Net Cost of Operations		
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. *Total resources used to finance items not part of the net cost of operations*	xxx	xxx
18. *Total resources used to finance the net cost of operations*	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
Components of the Net Cost of Operations that will not Require or Generate Resources in the *Current Period:*		
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. *Total components of net cost of operations that will not require or generate resources in the current period*	x,xxx	x,xxx
30. *Net Cost of Operations*	x,xxx	$ x,xxx

Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary.”

Statement of Federal Financial Accounting Standards 25: Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment

Status

Issued	July 17, 2003
Effective Date	Reclassifies "Risk Assumed" information and eliminates the "Current Services Assessment" for reporting periods beginning after September 30, 2002. Reclassifies the "Statement of Social Insurance" and other information about social insurance for reporting periods beginning after September 30, 2004.
Affects	• 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	• 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.

Table of Contents

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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background

8. In SFFAS 8, FASAB stated:

> 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.

[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.

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]

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.

[4]See 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.

12. The Board received 29 written comments on its December 2000 *Preliminary Views* from the following sources:

- 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 19 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.

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

[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.

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.

Current Services Assessment (CSA)

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.

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 16) 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.

[a]In 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.

[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.

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 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.

[7] As noted, certain GASB standards permit reference to another publicly-available report as an option for specified RSI.

Figure 2

-Low (implies RSI) < < < < < < < < < < < < < < < > > > > > > > > > > > > > > **+High (implies basic**)

<Relevance to fair presentation>

< Connection with elements of financial reporting >

< Use of historical financial data or financial transaction data >

<Preparers' discretion in preparing and presenting the information>

< Strength of signal Board wishes to be sent in the financial report >

< Significance, relevance or importance of the item in light of *Objectives* >

< Strength of the signal the Board wishes to be sent in the auditor's report >

< Relevance to measuring financial position or changes in financial position >

<Extent to which the information interests a wide audience (rather than specialists)>

<Extent to which there are not alternative sources of reliable information>

< Agreement on criteria that permit comparable and consistent reporting >

< Experience among users, preparers, and auditors with the information >

<Extent to which the information is aggregated (lacking in detail)>

< Benefit/cost ratio of using resources to ensure accuracy >

< Connection with basic financial statements >

< Reliability and/or precision possible >

< Reliability and/or precision needed >

-Low (implies RSI) < < < < < < < < < < < < < > > > > > > > > > > > > > **+High (implies basic**)

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 in paragraph 22-25, 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.

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 I7 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). . . .

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

[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."

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 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	November 1, 2004
Effective Date	For periods beginning after September 30, 2008
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).

Table of Contents

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.

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[1]In 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.

[2]SFFAS 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

A1. 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. [[4]For 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)

A2. 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.

A3. 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.

A4. 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.

A5. 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*.

A6. 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

A7. 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 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.
Affects	• 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.

Table of Contents

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 26[1], *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.

[1]The 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.

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 statement---not the material in this appendix---govern the accounting for specific transactions, events or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

A1. 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.

A2. 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	

A3. All ten respondents supported the proposed deferral.

Structure of the Amendment

A4. 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

A5. 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.

A6. The Board believes that a one-year delay is reasonable, necessary and appropriate in light of the delayed audit guidance.

Board Approval

A7. 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

A1. Paragraph 6 of SFFAS 25 is rescinded.

A2. 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

A3. ~~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 27: Identifying and Reporting Funds from Dedicated Collections

Status

Issued	December 28, 2004
Effective Date	For periods beginning after September 30, 2005
Affects	• SFFAS 7 • SFFAC 2 • SFFAC 3
Affected by	SFFAS 43 amends paragraphs 11-39.

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:

- 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 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

- 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.

Table of Contents

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 funds.[2] 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 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

[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.

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 Funds ………………..0000-3999		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 Funds ……………….6000-6999		X
Trust Funds …………………..8000-8999	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.

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 Funds from Dedicated Collections

11. Generally, funds from dedicated collections are financed by specifically identified revenues[3a], provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified

[3]Analytical Perspectives, Budget of the United States Government, Fiscal Year 2005, p. 339.

[3a]Such specifically identified revenue can be either exchange or nonexchange.

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 a fund from dedicated collections are:

1. A statute committing the Federal Government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source[3b] only for designated activities, benefits or purposes;

2. Explicit authority for the fund to retain revenues and/or 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[4] on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the federal government's general revenues.

Application of the Definition

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. A fund from dedicated collections 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 "funds from dedicated collections" 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 funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining

[3b]In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

[4]A "report" may be something other than stand-alone financial statements for the fund from dedicated collections.

certain objectives in accordance with special regulations, restrictions, or limitations."[5] Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:

1. its predominant sources of revenue and other financing sources are non-federal sources meeting the paragraph 11.1 criterion, or
2. it has non-federal sources of revenue and other financing sources meeting the paragraph 11.1 criterion[5a] that are material to the reporting entity.

For example, as currently funded, Medicare Parts B and D do not have non-federal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.

Distinct from the General Fund

14. Whereas funds from dedicated collections are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not dedicated 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 funds from dedicated collections reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Funds from dedicated collections may be given authority to make expenditures by means of 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 budget authority is provided by authorizing legislation or annual appropriations acts, the funds are reserved or restricted to the designated activity, benefit or purpose.

[5] National Council on Governmental Accounting Statement 1, par. 16.

[5a] In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:

1. long-term expectations rather than periodic results that may fluctuate
2. 36-month averages

Changes in classification of funds from year to year should be disclosed.

Distinct from Fiduciary Activities

15. The activity of funds from dedicated collections differs from fiduciary activities primarily in that in funds from dedicated collections 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 uphold.[6] Therefore, even though a fund from dedicated collections 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.

Distinct from Private Sector Trust Funds

16. Although funds from dedicated collections 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 funds from dedicated collections in the Federal Government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship.

17. A fund from dedicated collections 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.)

Exclusions from Reporting Requirements

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. Funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian or military) should not be classified as funds from dedicated collections because such funds account for employer-employee transactions and requirements tailored to those transactions are provided by SFFAS 5, Accounting for Liabilities of the Federal Government, paragraphs 56-96.[6a] In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position

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[6]See SFFAS 31, *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.

[6a]Because classification and reporting should be made at the level of an individual fund, portions of funds, such as the Federal Employees Compensation Account portion of the Unemployment Trust Fund, should not be excluded because of this provision.

of other funds from dedicated collections. The result at the government-wide level is that the large negative net position of these funds obscures the large cumulative amount that needs to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes.

Reporting for Funds from Dedicated Collections

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

19. The portion of cumulative results of operations and unexpended appropriations attributable to funds from dedicated collections should be shown separately on the Balance Sheet. This standard does not require funds from dedicated collections to be separately shown on the Statement of Net Cost. Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the statement of changes in net position if:

    1. dedicated collections are the predominant source of revenue and other financing sources for the component entity, or

    2. one or more of the entity’s funds from dedicated collections

        a. is of immediate concern to constituents of the fund,

        b. is politically sensitive or controversial,

        c. is accumulating large balances, or

        d. the information provided in the financial statements would be a primary source of financial information for the public

    For example, the Social Security and Medicare programs are of immediate concern to their constituents; both programs have a direct current or future impact on the majority of the general public.

19a. Entities may present combined or consolidated amounts and the presentation must be labeled accordingly.

19b. Component entities that do not separately show amounts from dedicated collections on the statement of changes in net position should refer on the face of the statement of changes in net position to the note on funds from dedicated collections.

20. Most revenues and other financing sources that are dedicated collections are reported 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 revenues and other financing sources that are dedicated collections, 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 disclose[8] all funds from dedicated collections for which it has program management responsibility by either a list (by official title), or a statement indicating where the list can be obtained (e.g., a website reference or contact information). A fund from dedicated collections 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. Information should be disclosed for each individual fund from dedicated collections. An exception is provided for component entities having numerous individual funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all the entity's funds from dedicated collections:

    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 providing gross cost, exchange revenue, net cost of operations, nonexchange revenues by major type and all other, other financing sources by major type and all other, and change in net position.

[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.

Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. The information required by this paragraph may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. The information must be in sufficient detail to support reporting requirements for the U.S. government-wide financial statements in paragraphs 29 and 30. Information for funds not presented individually may be aggregated. The total net position shown in the note disclosure should agree with the total net position for funds from dedicated collections shown on the face of the component entity's balance sheet.[9]

23. The following information should be disclosed for each individually reported fund from dedicated collections, 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 funds from dedicated collections to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

    a. quantitative factors such as

        1. the percentage of the reporting entity's revenues from dedicated collections or

        2. cumulative results of operations from such funds; and

    b. qualitative factors such as

        1. whether a fund from dedicated collections is of immediate concern to constituents of the fund,

[9] Footnote 9 was rescinded by SFFAS 43, *Revisions to Identifying and Reporting Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27*.

2. whether it is politically sensitive or controversial,

3. whether it is accumulating large balances, or

4. whether the information provided in the financial statements would be the primary source of financial information for the public.

25. The total net position of all funds from dedicated collections shown in the note disclosure should agree with the net portion of funds from dedicated collections shown on the face of the component entity's Balance Sheet.

26. In accordance with the provisions of paragraph 20 or footnote 5a of paragraph 13, if a component entity reports a different portion of a program funded by dedicated collections than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change. This applies if a component entity does not report a fund from dedicated collections that it reported in the previous year. It also applies if a component entity reports a fund from dedicated collections that it did not report in the previous year.

Note on Investments

27. Investments in Treasury securities for funds from dedicated collections 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 funds from dedicated collections. Instead, the cash generated from such funds is used by the U.S. Treasury for general Government purposes.
- Treasury securities are issued to the fund as evidence of dedicated collections 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 a fund from dedicated collections 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 fund from dedicated collections 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 above.

Intra-governmental Investments in Treasury Securities

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with funds from dedicated collections (or name/s of fund/s). The dedicated cash receipts collected from the public into the 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. Funds from dedicated collections should be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The portion of Net Position attributable to funds from dedicated collections 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 funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all funds from dedicated collections:

    1. Condensed information about assets, liabilities and net position.

[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.

2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

The disclosure may present combined or consolidated amounts and the presentation must be labeled accordingly.

31. The information for funds from dedicated collections 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 funds from dedicated collections shown on the face of the balance sheet.

32. A note disclosure should provide a reference to component reports for additional information about individual funds from dedicated collections.

33. A note disclosure should provide a general description of funds from dedicated collections and an explanation of how the Federal Government as a whole could provide the resources represented by the balance in Treasury securities held by funds from dedicated collections.

34. A fund from dedicated collections 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. [Paragraph 37 was superseded by paragraph 34 of SFFAS 31, which rescinded paragraphs 83 through 87 of SFFAS 7.]

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. <u>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.</u>

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~~ <u>earmarked funds</u>, 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

A1. 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

A2. 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.

A3. Several respondents requested guidance regarding criteria to consider in selecting earmarked funds for disaggregated disclosure; additional guidance has been included in this standard.

A4. 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.

A5. 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.

A6. 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.

A7. 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.

A8. Three respondents had questions about earmarked funds that have exchange revenue. Appendix C has been expanded to include both exchange and nonexchange revenue.

A9. 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

A10. 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]

A11. 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.

A12. 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.

A13. 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 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

A14. 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

[11] SFFAS 7, par. 83.

[12] Ibid.

[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.

"dedicated collections" regardless of whether or not they involved Government-owned funds or private funds. The concept of special accountability applies to earmarked funds.

A15. 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.

A16. 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 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

A17. 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.

A18. 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.

A19. 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

A20. 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.

A21. 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 1983.[15]

A22. 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.

A23. 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.

[15] Fiscal Year 2005 Historical Tables, Budget of the U.S. Government, pp. 118-119.

The investments in Treasury securities (an asset) held by the various earmarked funds and 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.

A24. 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.

A25. 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.

A26. 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

A27. 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

A28. 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.

A29. 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.

A30. 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

A31. 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.

A32. 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

A33. 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 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

A34. This statement was approved for issuance by all members of the Board.

[16] SFFAS 7, *Accounting for Revenue and Other Financing Sources*.

Appendix B: Glossary

[See consolidated Glossary in Appendix E of this document.]

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
Component Entity		
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
Component Entity		
Investments in Treasury Securities	1,000	
Fund Balance with Treasury		1,000
To record Treasury securities purchased.		

[18]This 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.		

[19]For 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 reporting[20]

(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]	(404)	
Change in net position	1,010	
Ending balance of net position	$ 1,010	$ -

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	1,000	
Total assets	$ 1,010	
LIABILITIES	$ -	$ -
NET POSITION		
Unexpended Appropriations	$ -	$ -
Cumulative Results of Operations	1,010	
Total Net Position	1,010	
Total liabilities and net position	$ 1,010	$ -

[20]This 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	400
Total revenue	1,000
Less net cost of operations	--
Net operating revenue	1,000
General Activities	
Revenue	--
Less net cost of operations	--
Net operating cost	--
Total net operating revenue (cost), all government activities	$ 1,000
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	--
Total Net Position	$ 1,000

1.E. (3) U.S. Government Balance Sheet

ASSETS	
Treasury Government-wide Cash Account	$ 1,000
Total assets	$ 1,000
LIABILITIES	$ --
NET POSITION	1,000
Social Security and Other Earmarked Funds	1,000
All Other	--
Total liabilities and net position	$ 1,000

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.

	ABC Fund	CDE Fund	Other Earmarked Funds	Total Earmarked Funds
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	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
LIABILITIES and NET POSITION				
Cumulative Results of Operations	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
Total Liabilities and Net Position	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
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	383,547	450,000	242,000	1,075,547
Less Earned Revenues Not Attributable to Programs				
Net Cost of Operations	$ 383,547	$ 450,000	$ 242,000	$ 1,075,547

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	67,698	300,000	78,000	445,698
Net Position End of Period	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458

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 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.
Affects	• SFFAS 6 • SFFAS 8 • SFFAS 14 • SFFAS 16
Affected by	• SFFAS 42 affects paragraphs 26, 28, 41 and 42. • SFFAS 59 transitionally amends paragraphs 33, 35, 39 and 42; rescinds and replaces paragraph 40 and inserts new paragraphs 36A-36D, 40A and 42A.
Related Guidance	• TR 9, Implementation Guide for SFFAS 29

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 information. 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, and a description of the methods of acquisition and withdrawal.

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.

Table of Contents

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 information.[1]

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. 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 information for the end of the reporting period, physical units added and withdrawn during the year, and a description of the methods of acquisition and withdrawal.

[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.

[2] [Deleted.]

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.

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 cost[3] 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).

20. With the exception of multi-use heritage assets (addressed in par. 23) no amounts for heritage assets acquired through donation or devise[4] 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.

[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*.

[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.

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 value[7].

Disclosures and Required Supplementary Information

25. Entities with heritage assets should reference a note[8] on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown[9]. 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 units[10] of measure for each major category should be meaningful

[7] See SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 for a discussion of transfers of assets.

[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.

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 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. [11,12] Entities should include a reference to deferred maintenance and repairs information[13] reported in required supplementary information.

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.

U.S. Government-wide Financial Statement Disclosures[14]

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:

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[11] Footnote deleted by SFFAS 42.

[12] Footnote deleted by SFFAS 42.

[13] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32* for information regarding definition, measurement and required supplementary information.

[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.

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.

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.

Definitions

33. Stewardship Land includes both public domain[14.1] and acquired land and land rights[15] owned by the Federal Government intended to be held indefinitely. Examples of stewardship land include land reserved, managed, planned, used, or acquired for[16]

[14.1] Public domain land is land that was originally ceded to the United States by treaty, purchase, or conquest in contrast to acquired lands, which have been purchased by, given to, exchanged with, or transferred through condemnation proceedings to the federal government.

[15] Land 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. Land rights such as easements or rights-of-way that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

[16] Land used or acquired for or in connection with items of general PP&E but meeting the definition of stewardship land should be classified as stewardship land.

a. forests and parks;

b. recreation and conservation;

c. wildlife habitat and grazing;

d. historic landmarks and/or the preservation of pre-historic and historic structures (those listed on or eligible for listing on the National Register of Historic Places);

e. multiple purpose ancillary revenue generating activity (for example, special use permits, mineral development activities, and timber production); and/or

f. buffer zones for security, flood management, and noise and view sheds.

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 meeting the definition of general PP&E established in SFFAS 6, as amended, should be accounted for in accordance with SFFAS 6, as amended.

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.

36A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[17.1] Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation, or any combination thereof.

36B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-

[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.

[17.1] Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

a. concession arrangements;

b. grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;

c. land sales or land exchanges;

d. leases;

e. permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;

f. forest product sales such as timber, or sales arising from national forests and grasslands; and/or

g. public-private partnerships.

36C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

36D. Operational land sub-category includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

a. Military functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.

b. Scientific functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).

c. Nuclear functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.

d. Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

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 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 devise[18] 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. The transferring and recipient entities should properly adjust for estimated acres of land information.

Disclosures and Required Supplementary Information

40. The following [*RSI information: FY 2022-2025*] [*disclosures: FY2026*][21-21.1] should be provided for stewardship land and permanent land rights:

    a. A concise statement defining an entity's federal land, and explaining how stewardship land relates to the mission of the entity.

    b. A brief description of the entity's policies for stewardship land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

    c. Information of land use by sub-category. Stewardship land and permanent land rights should be assigned to one of three sub-categories based on predominant use[21.1a] and reported in estimated acres of land. The three sub-categories are commercial use land; conservation and preservation land; and operational land.

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[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."

[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.

[21.1] Unless otherwise noted, [RSI information: FY 2022-2025] [disclosure: FY 2026] requirements are limited to the stewardship land category and are not required for each of the three sub-categories of conservation and preservation land; operational land; and commercial use land.

[21.1a] Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

Where stewardship land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land.[21.1b]

i. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at the end of each reporting period for land and permanent land rights.

d. If applicable, the amount of estimated acres of land held for disposal or exchange and their predominant use. For purposes of this Statement, stewardship land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

e. Stewardship land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

40A. The financial statement balance sheet should reference a note that [*presents RSI information: FY 2022-2025*] [*discloses: FY 2026*] required at paragraph 40 (a through e) about Stewardship land and permanent land rights but no asset dollar amount should be shown. Existing disclosures[21.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

41. [22, 23] Entities should include a reference to the deferred maintenance and repairs information[24] reported in required supplementary information.

[21.1b] Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

[21.2] For stewardship land, existing disclosures are those required by paragraph 40, titled "Disclosures and Required Supplementary Information" that are being rescinded (40.a through 40.d.3) effective fiscal year 2026. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

[22] Footnote deleted by SFFAS 42.

[23] Footnote deleted by SFFAS 42.

[24] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32* for information regarding definition, measurement and required supplementary information.

U.S. Government-wide Financial Statement Disclosures[25]

42. The U.S. Government-wide financial statement should include the following information:

    a. A concise statement including a general description of the federal government's land explaining how its federal land relates to the mission of the Federal Government.

    b. *[RSI information: FY 2022-2025] [A disclosure FY 2026]* of the estimated acres of land by predominant use sub-categories and estimated acres of land held for disposal or exchange by the Federal Government.

    c. A general reference to agency reports for additional information about stewardship land, such as agency policies and estimated acres of land.

42A. The U.S. Government-wide financial statement balance sheet should reference a note that *[presents RSI: FY 2022-2025] [discloses the FY 2026]* information about stewardship land and land rights required by paragraph 42, but no asset dollar amounts should be shown. Existing disclosures[25.1] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

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

[25.1] Existing disclosures at paragraph 42 are those which are in effect for reporting entities prior to the amendments contained at paragraphs 42 and 42A. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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]

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

[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.

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]

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]

[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*.

[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.

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. 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.

[32] See Stewardship (Objective 3) as described in SFFAC 1, *Objectives of Federal Financial Reporting*.

[33] See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government* par. 5

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	

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 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 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

[34] SFFAS 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."

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.

103. In its discussion in SFFAS 3, the Board relied on the FASB's concept as modified by certain concepts expressed in governmental auditing standards.[36] 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.

[35]See SFFAS 3, *Accounting for Inventory and Related Property*, par. 7-15.

[36]Par. 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 (Rescinded)

Status

Issued	August 15, 2005
Effective Date	For reporting periods beginning after September 30, 2008.
Affects	• SFFAS 4
Affected by	• SFFAS 55 rescinded SFFAS 30 in its entirety.
Related Guidance	Interpretation 6, *Accounting for Imputed Intra-departmental Costs;* TR 8, Clarification of Standards Relating to Inter Entity Costs

Summary

SFFAS 55, *Amending Inter-entity Cost Provisions*, rescinds SFFAS 30 in its entirety.

Statement of Federal Financial Accounting Standards 31: Accounting for Fiduciary Activities

Status

Issued	October 24, 2006
Effective Date	For periods beginning after September 30, 2008
Affects	• SFFAS 1, par. 26, 29, 31, 37, 38 • SFFAS 7, par. 83-87 (rescinded), 142, 276, 370 (rescinded) • Interpretation 1 (rescinded) • SFFAC 2, par. 84, 102
Affected by	• SIG 31.1

Summary

This statement defines "fiduciary activities" as those Federal Government activities that relate to the collection or receipt, and the subsequent management, protection, accounting, investment and disposition of cash or other assets in which non-Federal individuals or entities ("non-Federal parties") have an ownership interest that the Federal Government must uphold. The fiduciary relationship must be based on statutory or other legal authority and the fiduciary activity must be in furtherance of that relationship.

This statement requires Federal entities to distinguish the information relating to fiduciary activities of the Federal entity from all other activities of that Federal entity. Fiduciary assets will not be recognized on the balance sheet of any Federal entity. The Federal entity is required to include in its own audited financial statements a note disclosure providing the following information about its fiduciary activities:

- An explanation of the nature of the fiduciary relationship,
- A schedule of fiduciary net assets, and
- A schedule of fiduciary activity.

This requirement applies even if the Federal entity issues stand-alone audited financial statements for the fiduciary activity. For entities managing several distinct fiduciary activities, disaggregated information is required by activity.

The Financial Report of the United States Government (FR) will include a note disclosure describing the nature of the fiduciary activities of the Federal Government. The FR note disclosure will provide a list of component entities responsible for fiduciary activities and the total amount of fiduciary net assets for each responsible component entity. The FR note disclosure will refer the reader to the component entity financial statements for additional information about each component's fiduciary activity.

This statement is effective for periods beginning after September 30, 2008. Early adoption is not permitted. In the year this statement becomes effective, entities should not restate the prior period amounts presented in the basic financial statements and notes.

Table of Contents

Introduction

1. This statement defines **fiduciary activity**[1] and provides accounting and reporting guidance for fiduciary activities. Fiduciary activities should be distinguished from Federal programs designated as "trust funds" in the budget and in reporting to the Office of Management and Budget (OMB) and to the Treasury Financial Management Service (FMS). "Trust funds" included in the Federal budget are often established to carry out Federal programs, and their activity differs from the common understanding of trust **fund** activity outside of government. Most of the **revenue** received by Federal "trust funds" represents Government-owned collections "earmarked" or dedicated to finance or help to finance specific Federal programs rather than being held for the exclusive benefit of **non-Federal parties**. Non-fiduciary "trust funds" are addressed by Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds.* This standard addresses activities that are fiduciary in nature.

2. Fiduciary activities involve **ownership interests** described in this statement (see paragraph 10). The Federal employees' Thrift Savings Fund and the Indian tribal and individual Indian trust funds are examples of fiduciary activities.

3. In order to clarify financial reporting in general purpose Federal financial reports, this standard defines fiduciary activity and provides financial reporting guidance for fiduciary activity and for fiduciary assets and liabilities.

4. This standard requires that the terms "**fiduciary,**" "**fiduciary assets**," "fiduciary fund," and "fiduciary activity" be used in general purpose Federal financial reports to characterize only fiduciary activity as defined in this standard. Non-fiduciary "trust fund" assets and activity related thereto should not be characterized as "fiduciary" or "trust" activity in general purpose financial reports of Federal **entities**. Such reporting would obscure an essential fact: that the Federal Government uses the non-fiduciary assets in support of its programs.

5. This standard requires that Federal entities disclose fiduciary assets, liabilities and flows in a note **disclosure**. Fiduciary assets and liabilities should not be recognized on the balance sheet of the Federal entity.

6. This standard also clarifies the definition and reporting for fiduciary cash that is on deposit in the U.S. Treasury. Fiduciary cash deposits are referred to as **Fiduciary Fund Balance with Treasury** (Fiduciary FBWT). This deposit activity is not fully addressed in Statement of Federal Financial Accounting Standards 1, *Accounting for Selected Assets and Liabilities.*

[1] Words first appearing in boldface are defined in Appendix B: Glossary

SFFAS 1 explains that "in some circumstances, the entity deposits cash in its accounts in a fiduciary capacity for the U.S. Treasury or other entities."[2] However, some unique aspects of Fiduciary FBWT are not included in SFFAS 1. For example, SFFAS 1 defines FBWT as "the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities." SFFAS 1 further explains that "Fund Balance with Treasury is an intragovernmental item." However, Fiduciary FBWT is not an intragovernmental item; the owner of Fiduciary FBWT is a non-Federal party. This standard amends SFFAS 1 to distinguish fiduciary FBWT from Federal component entities' FBWT.

7. Numerous "fund groups[3]" are used in reporting to the Treasury FMS and the OMB. For example, "**deposit funds**" may be used for monies that do not belong to the Federal Government. Regardless of how a fund group may be classified in reporting to the Treasury FMS or to the OMB, only those activities that meet the definition of fiduciary activity promulgated in this standard are subject to the reporting requirements of this standard. Activities that do not meet the definition of fiduciary activities promulgated in this standard are not subject to the reporting requirements of this standard. Deposit funds that do not meet the definition of fiduciary activities, and therefore are not disclosed in the fiduciary note disclosure, should be recognized in the principal financial statements.

Scope

8. This statement provides financial reporting standards for fiduciary activities in the general purpose financial statements for Federal entities. The standard does not affect reporting in the *Budget of the United States* or special-purpose reports.

Effective Date

9. This standard is effective for periods beginning after September 30, 2008. In the initial year of implementation, comparative information should not be restated. Earlier adoption is prohibited.

[2] SFFAS 1, paragraph 29.

[3] For a description of "fund groups" used in reporting to the Treasury FMS and the OMB, see the Treasury Financial Manual, Part 2, Chapter 1500.

Accounting Standard

Definition and Characteristics of Fiduciary Activities

Definition

10. In a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which **non-Federal individuals or entities** (or "non-Federal parties") have an ownership interest that the Federal Government must uphold. Non-Federal parties must have an ownership interest in cash or other assets held by the Federal entity under provision of law, regulation, or other fiduciary arrangement. The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation.

Characteristics

11. Fiduciary activities are initiated by **fiduciary collections**. Fiduciary collections are an inflow to a Federal entity or its non-Federal designee (such as a commercial bank) of cash or other assets that are and remain the property of non-Federal parties. Fiduciary collections may be preceded by the recognition of fiduciary accounts receivable.

12. Fiduciary activities may involve a variety of fiduciary assets, liabilities and transactions. Examples include but are not limited to:

    <u>Cash:</u>

    Fiduciary cash may be held in a variety of ways. Cash may be represented by balances on deposit with the U.S. Treasury[4] or commercial banks.

[4] The U.S. Treasury is in the Treasury Department, which is the primary fiscal agent for the Federal Government. The Treasury Department collects money due to the United States, makes payments, manages borrowings, performs central accounting functions, and produces coins and currency sufficient to meet demand. The Treasury Department manages the Government's daily cash position and borrowing as well as the investment of funds in its custody. The Treasury Department provides Central Accounting System (CAS) services to Federal agencies. CAS transactions involve appropriation credits, transfers-in and -out, collections, disbursements and related adjustments. Such transactions increase or decrease Federal entities' **Fund Balance with Treasury** (FBWT) maintained with the Treasury Department.

Investments:

Fiduciary assets may include investments in Treasury securities or in non-Treasury securities.

Other Assets:

Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending disposition, or held long-term in a fiduciary capacity.

Liabilities:

A fiduciary activity may include expenses that will be paid with fiduciary assets. This may result in fiduciary liabilities that will be settled with fiduciary assets.

Inflows:

A fiduciary activity may include collections of cash or other assets that represent contributions from or for beneficiaries or revenue derived from fiduciary assets.

Outflows:

A fiduciary activity may include expenses that will be paid with fiduciary assets and distributions of assets to the beneficiaries.

Exclusions

13. The following are excluded from the reporting requirements for fiduciary activities, and should be recognized in the principal financial statements of the Federal component entity and not in the fiduciary note disclosure:

- Amounts related to unpaid[5] **payroll withholdings** and **garnishments**[6] are excluded from the reporting requirements of this standard. Liabilities for unpaid payroll withholdings and garnishments should be recognized as accounts payable in

[5] "Unpaid" means that amounts withheld or garnished have not been paid to the designated recipient of the amounts withheld or garnished.

[6] Examples of garnishments include amounts withheld from an individual's salary or tax refund for payments of child support or to another third party in compliance with a statute or court order.

accordance with existing standards.[7]

- **Unearned revenue** should not be reported as fiduciary activity and should be recognized as a liability in accordance with existing standards.[8] Assets collected or received by a Federal entity that represent prepayments or advance payments for which the Federal component entity is expected to provide goods or services should not be classified as fiduciary activity. This exclusion applies broadly and applies to amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process, even if these amounts are not specifically classified as "unearned revenue" by the entity due to uncertainty about the ultimate realization of the revenue.

14. Amounts related to operating revenues and expenses in ways that are consistent with the above exclusions also may be excluded.

15. **Seized property**, including seized monetary instruments, is not subject to the reporting requirements for fiduciary activities because it does not meet the definition of a fiduciary activity. Seized assets, including seized monetary instruments, should continue to be reported in accordance with existing standards.[9]

Basis of Accounting

16. Fiduciary activities reported in the Federal entity's notes to the financial statements, as required in paragraphs 17-24, should be disclosed in the required schedules and measured using the standards provided in generally accepted accounting principles.[10]

[7] See SFFAS 1, *Accounting for Selected Assets and Liabilities*, paragraphs 74-86.

[8] See SFFAS 1, paragraph 85 and SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraph 37.

[9] See SFFAS 3, *Inventory and Related Property*, paragraphs 61 and 69.

[10] For the definition of generally accepted accounting principles see the American Institute of Certified Public Accountants *Professional Standards*, U.S. Auditing Standards (AU) Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles."

Accounting and Reporting for Fiduciary Activities for Component Entities

Reporting of Fiduciary Activities

17. Reporting on fiduciary activities is required in two notes to the financial statements. The note disclosing significant accounting policies[11] should include, at a minimum, a statement that: "Fiduciary assets are not assets of the [Federal component entity] and are not recognized on the balance sheet. See Note xx, Fiduciary Activities."

18. A separate note to the financial statements should include the following information for individual fiduciary activities:

    a. A description of the fiduciary relationship, e.g., the applicable legal authority, the objectives of the fiduciary activity, and a general description of the beneficial owners or class of owners.

    b. A Schedule of Fiduciary Activity displaying, for all periods presented:

    - The beginning balance of net assets,
    - The inflows from the fiduciary activities by category (e.g., contributions, investment earnings) and outflows by category (e.g., benefit payments, refunds, administrative expenses),
    - The change in net assets, and
    - The ending balance of net assets.

    c. A Schedule of Fiduciary Net Assets displaying the current and prior period ending balances of cash and any other assets by category (e.g., receivables, investments), and liabilities by category (e.g., accounts payable, refunds payable), and a variance analysis addressing significant changes from the prior period. The disclosure for non-monetary fiduciary assets should include a description of the composition of the assets, the method(s) of valuation, and changes (if any) from prior period accounting methods.

    d. Component entities also may have **non-valued fiduciary assets.** Non-valued fiduciary assets are fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Component entities holding non-valued fiduciary assets should disclose them in a Schedule of Changes in Non-Valued

[11] A note disclosing "Significant Accounting Policies" is a requirement of the Office of Management and Budget (OMB). This disclosure is currently listed as Note 1 in "Form and Content of the Performance and Accountability Report" issued as Part A of OMB Circular A-136.

Fiduciary Assets, which should include a description of non-valued fiduciary assets, beginning quantity, quantity received, quantity disposed of, net increase/decrease in non-valued fiduciary assets, and ending total quantity.

e. If separate audited financial statements are issued for an individual fiduciary activity, additional disclosures listed in paragraph 22 should be provided. If the separate audited financial statements for an individual fiduciary activity are prepared with a fiscal year-end other than September 30, the information required in this paragraph may be provided for the fiduciary activity's most recent fiscal year, provided that the information is clearly labeled.

19. Most fiduciary activities are disclosed by the Federal component entity responsible for administering the fiduciary activity on behalf of the beneficiaries. If more than one Federal component entity is responsible for administering a fiduciary activity, and the separate portions of the activity can be clearly identified with a responsible component entity, then each component entity should disclose its portion in accordance with the requirements of this standard. In such cases, each component entity should identify the other component entities that are involved in managing the activity. If separate portions cannot be identified, the component entity with program management responsibility should disclose the fiduciary activity.[12]

20. For component entities with several distinct fiduciary activities, summary financial information required in paragraph 18 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 21) may be aggregated.

21. Selecting fiduciary activities 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 fiduciary net assets or inflows; and qualitative factors such as whether a fiduciary activity is of immediate concern to **beneficiaries**, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the fiduciary note disclosure would be the primary source of financial information for the public.

22. If separate audited financial statements are issued for an individual fiduciary activity that is presented individually in accordance with the criteria described in the preceding paragraph,

[12] To determine program management responsibility, Federal component entities should consider the legislation authorizing the activity; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display*.

a. The fiduciary note should disclose the basis of accounting used and auditor's opinion on the current or most recent financial statements. If the auditor's opinion was not unqualified, the fiduciary note also should disclose the reason(s) stated by the auditors and refer the reader to the audit opinion for further information.

b. The note disclosure should provide information on how the reader can obtain a copy of the financial statements and the audit opinion thereon.

23. In the initial year of implementation, prior year information should not be displayed. In the reporting periods following the initial year of implementation, prior period amounts should be displayed.

24. Notes to the financial statements are an integral part of the basic financial statements, essential for complete and fair presentation in conformity with generally accepted accounting principles for the Federal Government.

Financial Report of the United States Government

25. Reporting on fiduciary activities is required in two notes to the financial statements. The note disclosing significant accounting policies[13] should include, at a minimum, a statement that: "Fiduciary assets are not assets of the Federal Government and are not recognized on the balance sheet of the U.S. Government. See Note xx, Fiduciary Activities."

26. In the consolidation process, a distinction must be made between Federal component entities' Fund Balance with Treasury (FBWT) recognized on the balance sheet at the component entity level and the FBWT attributable to fiduciary activities (fiduciary FBWT) reported by Federal component entities in a note disclosure. The liability for fiduciary cash held as FBWT should be recognized as a liability on the Government-wide balance sheet. The liability for fiduciary investments in Treasury securities should be recognized on the Government-wide balance sheet as debt held by the public.

27. The fiduciary note disclosure should include a definition of fiduciary activities, a description of the nature of the Federal Government's fiduciary activities, a list of component entities responsible for fiduciary assets, and the total amount of fiduciary net assets for each responsible component entity. Aggregation of component entities with immaterial amounts of fiduciary net assets is permitted.

[13] A note disclosing "Significant Accounting Policies" is a requirement of the Office of Management and Budget (OMB). This disclosure is currently listed as Note 1 in "Form and Content of the Performance and Accountability Report issued as Part A of OMB Circular A-136.

28. In the initial year of implementation, prior year information should not be displayed. In the reporting periods following the initial year of implementation, prior period amounts should be displayed.

29. The note disclosure should refer the reader to component entity financial statements for additional information.

30. Notes to the financial statements are an integral part of the basic financial statements, essential for complete and fair presentation in conformity with generally accepted accounting principles for the Federal Government.

Effect on Current Standards

31. This standard affects current standards for reporting non-entity assets. Paragraphs 26 and 29 of SFFAS 1, *Accounting for Selected Assets and Liabilities*, are amended as follows:

[26] Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements**, except for non-entity assets meeting the definition of fiduciary assets, which should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.*** Non-entity assets ~~reported in~~ **recognized on** an entity's ~~financial statements~~**balance sheet** should be segregated from entity assets. An amount equal to non-entity assets **recognized on the balance sheet** should be recognized as a liability (due to Treasury or other entities) ~~in the entity's financial statements~~.

[29] ***Non-entity cash.*** Non-entity cash is cash that a federal entity collects and holds on behalf of the U.S. Government or other entities. In some circumstances, the entity deposits cash in its accounts in a ~~fiduciary~~ **custodial** capacity for the U.S. Treasury or other **federal component** entities**, or in a fiduciary capacity for non-federal parties.**

(a) Non-entity cash **recognized on the balance sheet** should be reported separately from entity cash.

(b) Non-entity cash meeting the definition of a fiduciary asset should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.*

32. This standard affects current standards that define Fund Balance with Treasury. Paragraph 31 of SFFAS 1 is amended as follows:

[31] A federal entity's fund balance with the Treasury **(FBWT)** 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. ~~Fund balance with Treasury~~ **FBWT** is an intragovernmental item, **except for fiduciary or other non-federal non-entity FBWT.** From the reporting entity's perspective, **the reporting entity's** ~~a fund balance with Treasury~~ **FBWT** is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. **In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.**

33. Paragraphs 37 and 38 of SFFAS 1 are amended, and a new paragraph is added, as follows:

[37] Disclosure should be made to distinguish ~~two~~ **three** categories of funds within ~~the entity's fund balance with Treasury~~ **FBWT reported on the entity's balance sheet**: the obligated balance not yet disbursed**,** ~~and~~ the unobligated balance**, and non-budgetary FBWT**. The obligated balance not yet disbursed is the amount of funds against which budgetary obligations have been incurred, but disbursements have not been made.

[38] The unobligated balance is the amount of funds available to an entity against which no claims have been recorded. Unobligated balances are generally available to a federal entity for specific purposes stipulated by law. Unobligated balances may also include balances in expired/canceled accounts that are available only for approved adjustments to prior obligations. Certain unobligated balances may be restricted to future use and are not apportioned for current use. Disclosure should be provided on such restrictions. **Non-budgetary FBWT includes unavailable receipt accounts, clearing accounts and other accounts that do not represent budget authority, as well as non-entity FBWT that is recognized on the balance sheet.**

[New Paragraph] In addition to entity and non-entity FBWT that is recognized on the balance sheet, a federal entity may also administer fiduciary FBWT on behalf of non-federal entities or individuals. Fiduciary FBWT is not recognized on the balance sheet, but is subject to separate disclosure requirements. For disclosure requirements for fiduciary FBWT, see SFFAS 31, *Accounting for Fiduciary Activities.*

34. This standard affects current standards dealing with fiduciary activity and fiduciary relationships in SFFAS 7, *Accounting for Revenue and Other Financing Sources*. Paragraphs 83-87 and 370 of SFFAS 7 are rescinded. In addition, paragraphs 142 and 276 of SFFAS 7 are amended as follows:

[142] MMS collects this revenue ~~**acting as an agent for**~~ **<u>and distributes it to</u>** 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 **<u>it collects as an agent for the U.S. Treasury or other federal component entities</u>** as a custodial activity, which is an amount collected **<u>or to be collected</u>** for other~~s~~ **<u>federal entities,</u>** in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. **<u>MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for Fiduciary Activities.*</u>** 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.

[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~~ **<u>and distributes the collections to</u>** 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. **<u>MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for Fiduciary Activities.*</u>** The amounts of revenue should be recognized and measured under the exchange revenue standards when they are due pursuant to the contractual agreement.

35. This standard also amends paragraphs 84 and 102 of SFFAC 2, *Entity and Display*, as follows:

[84] The elements most likely to be presented in the balance sheet of a Federal suborganization/organization, program, or the entire government would be as follows:

- **Fund Balance with Treasury.** This represents the amount in the entity's accounts with the **<u>U.S.</u>** Treasury that is available only for the purpose for which the funds were appropriated. It ~~would~~ **<u>may</u>** also include balances held by the entity in the capacity of a banker or agent for others. **<u>However, Fund Balance with Treasury (FBWT) meeting the definition of fiduciary FBWT should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.*</u>** ~~This classification would not be included in the financial statements of the U.S. Government.)~~

[102] Custodial collections do not include deposit funds, i.e., amounts held temporarily by the government (e.g., bidders' earnest money or guarantees for performance) or amounts held by the Government as an agent for others~~,~~ (e.g., state income taxes withheld from

Federal employees' salaries that are to be transferred to the states~~.~~)**.** ~~Both of t~~**T**hese types of collections ~~can be considered assets and liabilities until they are returned to the depositor or forwarded to the organization entitled to the funds~~ **should be reported in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities***.

36. Interpretation No. 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*, is rescinded.

Effective Date

37. This standard is effective for periods beginning after September 30, 2008. In the initial year of implementation, comparative information should not be restated. Earlier adoption is prohibited.

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by the Board in reaching the conclusions in this standard. 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 standards - not the material in this or other appendices - should govern the accounting for specific transactions, events or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Outreach activities

38. FASAB published the revised[14] exposure draft (ED), *Accounting for Fiduciary Activities*, on June 27, 2005. 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, the CFO Council, the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past. Copies of the ED and letters requesting comments were also sent to individuals who spoke at the October 2003 public hearing for the original ED, as well as to the Federal Retirement Thrift Investment Board.

39. During the comment period, FASAB staff also gave informational presentations at the 15th Annual Government Financial Management Conference sponsored by Treasury Agency Services, and at July 2005 meetings of the Financial Statement Audit Network, the OMB

[14] The first exposure draft was issued on April 23, 2003. Issues raised by respondents to that exposure draft caused the Board to revise its proposal.

Form and Content Work Group, the Greater Washington Society of CPAs, and the U.S. Standard General Ledger Board's Issues Resolution Committee. A public hearing was also held on August 17, 2005.

Comments Received

40. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

41. Fourteen written responses were received from the following sources:

Comment letters and/or oral testimony provided by:	Federal (Internal)	Non-Federal (External)
Users, academics, others		3
Auditors	3	
Preparers and financial managers	8	

42. Note: The response from one Federal agency's Office of the Inspector General listed above under "auditors," noted that the response represented the consensus expressed by the agency's Office of the Chief Financial Officer as well as the agency's auditors.

43. Also, one Federal agency wrote that it had no comments because the agency's funds are primarily earmarked funds rather than fiduciary.

44. At the public hearing held on August 17, 2005, representatives from two Federal agencies provided oral statements and answered questions from the Board.

Summary of Comments

45. The majority of respondents agreed with the definition of fiduciary activities, the proposed reporting requirements, and the exclusions from the reporting requirements. Other issues raised by respondents included how to report on fiduciary activities that issue separate audited financial statements; the ownership interest(s) for seized assets; the appropriate basis of accounting for fiduciary activities and the effective date of the standard.

Definition

46. The Board believes that the substance of a transaction, rather than its form, should be the determining factor in how it is reported. Accordingly, this standard provides a definition and

characteristics for fiduciary activity and does not provide lists of specific funds or fund groups. Some respondents have noted that often fiduciary activities are managed through the establishment of a deposit fund. Therefore, the following section is intended to assist Federal financial managers in understanding the role of deposit funds.

The Role of Deposit Funds

47. Federal component entities report budgetary and proprietary transactions to the OMB and the Treasury FMS using "fund account symbols," which are sub-components of Federal reporting entities. Fund account symbols are assigned by the Treasury FMS in collaboration with the OMB. Based upon certain characteristics, fund account symbols are classified into "fund groups." For example, "deposit funds" are a fund group for monies that do not belong to the Federal Government.[15] The OMB classifies deposit funds as non-budgetary activities and excludes deposit funds from the Federal budget.[16] Within the "deposit fund" group established by the Treasury FMS, there are three distinct types: (a) monies withheld from Government payments for goods and services received, including payroll withholdings and garnishments; (b) monies the Government is holding awaiting distribution based on a legal determination or investigation; and (c) deposits received from outside sources for which the Government is acting solely as a banker, fiscal agent or custodian.[17] Although some fiduciary activities may be recorded and reported in deposit funds, the use of a deposit fund for an activity does not automatically indicate that the activity meets the definition of fiduciary in this standard. The activity in each deposit fund should be reviewed to determine whether it meets the definition and characteristics of a fiduciary activity in this standard. Also, if an activity is not reported in a deposit fund, that fact does not necessarily mean that the activity does not meet the definition of fiduciary in this standard. Each activity must be evaluated based upon whether or not it meets the definition of a fiduciary activity in this standard.

Exclusions

48. Payroll withholdings and garnishments appear to meet the definition of fiduciary activities. When an employer withholds an amount from an employee's wages, the employer has a responsibility to forward those amounts to the required recipient. However, this standard excludes payroll withholdings and garnishments from the reporting requirements for

[15] Treasury Financial Manual (TFM) Volume 1, Part 2, Section 1535, available on the Internet at http://www.fms.treas.gov/tfm/vol1/index.html

[16] See FY 2006 U.S. Budget, *Analytical Perspectives*, pp. 372, 377 and 378-379.

[17] TFM, Section 1535.

fiduciary activities because payroll withholdings and garnishments are similar to other unpaid costs of operations and do not warrant special reporting. Because of the routine operational nature and short duration of the activity, the Board does not believe that fiduciary reporting of payroll withholdings and garnishments would produce useful information.

49. Similarly, Federal component entities may hold advances received from customers for future sales of goods or services. Such advances represent unearned revenue. One Federal agency, in its written response and oral testimony, noted that certain advances received appear to meet the definition of fiduciary activity. However, this standard excludes unearned revenue from the fiduciary reporting requirements because unearned revenue is a routine operational activity and the Board believes that fiduciary reporting of unearned revenue is not warranted.

50. The standard clarifies the fact that seized property is not subject to the fiduciary reporting requirements because seized assets do not meet the definition of fiduciary activities. In seizure-for-forfeiture the Government is asserting its right to the property, and is taking action to eliminate, rather than to uphold, the ownership interest of the non-Federal party.

Reporting Standards

51. The Board discussed the implications of recognizing fiduciary assets on the balance sheet or on a separate principal statement. The Board considered whether recognizing fiduciary assets on the balance sheet might imply not only managerial control over the assets, but also that the benefit of the assets accrue to the Federal component entity. The Board decided that fiduciary assets should not be recognized on the balance sheet of the Federal component entity because they are not assets of either the Federal component entity or the Federal Government as a whole. The Board considered whether fiduciary activity should be recognized in a separate principal financial statement, but decided that a note disclosure would be preferable, provided that the note disclosure contains adequate information regarding fiduciary assets and activities.

Basis of Accounting

52. Some members of the Board have dissented to the standard and their reasons are presented at paragraph 63. These members oppose requiring the disclosures to be measured in accordance with generally accepted accounting principles. Two reasons are offered in the written dissent.

53. Some of the members dissenting stated that the Board should not impose requirements on reporting information related to “non-Federal entities.” However, a majority of the Board believe that fiduciary activities as defined in this standard are Federal program activities,

carried out by Federal employees often with federal funding of administrative expenses. The amount and sources of financing fiduciary activities are determined by Congress. The assenting Board ;members believe that although the assets in fiduciary funds are non-federal assets, the responsibility for managing the assets is a federal responsibility and the funds holding the assets are federal accounting entities established to carry out that responsibility.

54. A major objective of general purpose financial reporting in accordance with generally accepted accounting principles is to meet the needs of users who have limited access to internal documents or statements and lack the ability to demand that desired information be provided. Most citizens and beneficiaries of fiduciary funds lack such ability.

55. Some of the members dissenting stated that the cost-benefit of the requirement to disclose information in conformity with generally accepted accounting principles has not been demonstrated. However, a majority of the Board believes that the need for accountability by public officials is sufficient in its own right to justify the requirement to conform to generally accepted accounting principles. Further, the Board notes that:

a. Current standards (SFFAS 7, paragraphs 83-87) already require accrual accounting for fiduciary activities; therefore, this standard is merely carrying forward existing requirements and is not introducing new costs.

b. This standard requires the same basis of accounting that is required for Federal assets, liabilities and flows. Accounting systems on that basis are routinely in operation throughout the government and pose no unusual costs for fiduciary activities.

c. The Board is permitting generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board) to be used. This should mitigate any costs for fiduciary activities currently reporting with a different source of generally accepted accounting principles.

d. The Board is permitting the use of information based on a fiscal year-end other than the fiscal year-end used by the Federal Government. This will mitigate the cost for fiduciary activities currently producing audited financial statements on a different fiscal year.

Custodial Activity Differs from Fiduciary Activity

56. The Statement of Custodial Activity is not amended by this standard. The Statement of Custodial Activity is appropriate for custodial collections, which are amounts collected by one Federal component entity on behalf of another Federal component entity and associated with that other entity in the Federal budget. For example, the Internal Revenue Service (IRS) and the Bureau of Customs and Border Protection (Customs) make

collections of income taxes and customs duties, respectively, and they are deposited into designated accounts of the Treasury, which are unavailable to either for use in their operations.[18] The IRS and Customs would report such collections on a Statement of Custodial Activity and the responsible program entity would recognize revenue and the related assets. Thus, the Statement of Custodial Activity is appropriate for those Federal component entities whose primary mission is collecting taxes or other Federal revenues, particularly sovereign revenues that are intended to finance the entire Government's operation, or at least the programs of other Federal component entities, rather than their own activities.[19] Guidance with respect to the Statement of Custodial Activity is provided in Statement of Federal Financial Accounting Concepts (SFFAC) 2 and SFFAS 7.

57. Reporting requirements for fiduciary activities are different from reporting requirements for custodial activities. Although the inflows and assets reported on the Statement of Custodial Activity are not inflows or assets of the Federal component entity, they are inflows and assets of the Federal Government as a whole. In contrast, fiduciary inflows and assets are not inflows of net assets to the Federal Government. Accordingly, fiduciary activities are disclosed in a note and are not recognized on the Statement of Custodial Activity or any other principal financial statement.

58. Because fiduciary assets are not recognized on the balance sheet of the reporting entity, there is no offsetting liability, as there is for custodial assets. The fiduciary note discloses the beneficiaries' equity as "fiduciary net assets."

Effective Date

59. This standard requires that fiduciary assets and liabilities be disclosed in a note, and should not be recognized on the face of the balance sheet. In order to facilitate the preparation of the Financial Report of the U.S. Government, a uniform implementation date for all Federal component entities is necessary. Accordingly, early implementation of this standard is prohibited, and Federal component entities should not restate prior periods in the initial year of implementation. The effective date is intended to allow Federal agencies adequate time to comply with the reporting requirements.

[18] Implementation Guide to Statement of Financing in Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources*: Detailed Information on the Statement of Financing, par. 25.

[19] SFFAC 2, par. 101.

Effect on Existing Standards

60. The Board promulgates standards for activities that are defined by specific characteristics, and not by how an activity may be labeled in the budget or reported to the Treasury Financial Management Service. Paragraph 370 of SFFAS 7 addressed the group of funds designated as “deposit funds” as follows:

> [370] 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.

61. The Board decided that this paragraph was not sufficiently clear that all deposit funds that are not disclosed in the fiduciary note should be recognized in the principal financial statements of the Federal component entity. Accordingly, paragraph 370 of SFFAS 7 is rescinded by this standard and an explanatory sentence was added to paragraph 7 in the introduction section of this standard. All deposit funds that do not meet the definition of fiduciary activities and therefore are not disclosed in the fiduciary note must be recognized on the face of the financial statements.

Board Approval

62. This statement was approved by the Board with a vote of six members in favor of its issuance and four members, Messrs. Dacey, Patton, Reid and Zavada, opposing its issuance.

Dissents

63. Messrs. Dacey, Patton, Reid and Zavada dissented to this standard. Their dissent is presented below. Some members who voted to issue the standard agree with certain of the arguments posed by the dissenters but believe that, on balance, the standard is an improvement in Federal financial reporting.

Dissent of Messrs. Dacey, Patton, Reid and Zavada

63a. Paragraph 16 of the proposed standard requires that information disclosed about fiduciary activities be presented on the basis of generally accepted accounting principles. Board members Robert Dacey, James Patton, Robert Reid, and David Zavada support disclosure of information on fiduciary activities, but disagree with this requirement. These members believe that, at a minimum, the words “and measured using the standards provided in generally accepted accounting principles" should be deleted from paragraph 16 and replaced with words such as "and measured on the basis of accounting used to maintain or report the information." While these members do not disagree that generally accepted accounting principles (GAAP) financial reporting enhances the quality of reported financial information, they nonetheless disagree that the Board should require information related to fiduciary activities to be presented on a GAAP basis. The reasons for these views and the members supporting each of these reasons are as follows:

The Board Should Not Impose Requirements on Reporting Information Related to Non-Federal Entities

64. Board members James Patton and Robert Reid believe that the Board should not impose requirements on reporting information related to non-Federal entities, including the basis of accounting to be used in disclosures related to such non-Federal entities. Fiduciary activities, as defined in the proposed standard, represent activities of non-Federal entities. All entities are obligated to choose the basis of accounting that will be used to prepare financial information and whether such information will be audited, consistent with any legal and regulatory requirements. In some known instances and likely in others, information related to these non-Federal entities is not maintained or reported on a GAAP basis and/or are not audited.

65. Other organizations are positioned to require the basis of accounting to be used by the non-Federal entities that represent fiduciary activities to the Federal government, as well as require the information to be audited. The beneficiaries/owners that have an interest in the non-Federal entities' activities and oversight bodies that represent them and the respective Federal entities are best positioned to determine the basis of accounting and reporting and audit assurance that best meets their needs. For example, the beneficiaries/owners of the non-Federal entities may have agreements in place covering the basis of accounting used or the audit assurance to be provided. In addition, the basis of reporting and audit assurance can be determined by the courts, by statute or by policy.

66. In summary, the Board should not mandate disclosure of financial information on a basis of accounting that is different from the basis used to maintain or report information related to these non-Federal entities nor require that such information be audited on an individual fiduciary activity basis. However, as part of the current Federal entity project, the Board can reconsider whether certain or all entities representing fiduciary activities should be considered to be Federal entities, and therefore be required to follow Federal GAAP and be audited.

The Cost-Benefit of the Requirement Has Not Been Demonstrated

67. Board members Robert Dacey, Robert Reid, and David Zavada do not believe that it has been demonstrated that the requirement to disclose information in conformity with GAAP is cost-beneficial (i.e., benefits clearly exceed the additional costs that would be incurred.) As noted above, in some known instances and likely in others, information related to non-Federal entities that represent fiduciary activities to the Federal Government is not maintained or reported on a GAAP basis and/or are not audited.

68. In their response to the exposure draft, the Department of the Interior indicated that they were maintaining the Indian Trust Fund information on a basis of accounting that was consistent with trust activity of commercial banks and institutions and they questioned the benefit of converting the information to a Federal GAAP basis of accounting.

69. Requiring the Federal entities to report financial information on these non-Federal entities in their footnotes on a GAAP basis will incur additional costs, which could be substantial. Furthermore, requiring such disclosure will not require the non-Federal entity to maintain or report financial information on a GAAP basis of accounting. Financial information disclosed in the Federal entity financial statements that is different from information provided to fiduciary owners/beneficiaries and oversight bodies could result in confusion. Such confusion further decreases the benefit of the requirement to report fiduciary activities on a GAAP basis.

70. The disclosure of fiduciary activities in Federal financial statements is not designed to be the primary source of information to owners/beneficiaries of these non-Federal entities. Rather, such beneficiaries should receive information directly from the non-Federal entity or related Federal entity. In the case of the larger fiduciary activities, such information is provided or available, both at an aggregate and individual account holder level.

71. A primary purpose of disclosing fiduciary activities in a Federal entity's financial statements is to demonstrate the nature and extent of the Federal Government's fiduciary responsibilities and whether the Federal entity is adequately carrying out its fiduciary responsibilities. Therefore, disclosure of (1) information prepared on the basis of accounting used to maintain or report the financial information to beneficiaries/oversight bodies, (2) the basis of accounting used (including whether or not it was prepared on a Federal GAAP basis), (3) whether the information was audited, and (4) the type of opinion issued, provides sufficient information that users and oversight bodies (e.g., Congress, OMB) may use to determine the adequacy of Federal actions to discharge their fiduciary responsibilities. It has not been demonstrated that incurring additional costs to develop disclosures beyond these would provide significant benefits relative to the additional costs.

72. The nature and extent of all fiduciary activities have not been identified nor have the related costs to meet the requirements of the proposed standard. In addition to the major fiduciary activities discussed by the Board, there may be many other fiduciary activities for which Federal GAAP-based information is not maintained or reported and/or are not audited. Also, the cost of developing accrual-based information, if available, is unknown. In addition, an Interior official indicated that certain accruals, such as for royalties on the thousands of oil and gas leases held and for timber sales on behalf of the Indian trust funds are not readily determinable, and if estimated, would not be reliable. Therefore the relative magnitude of the ultimate cost of adopting this requirement is not known.

73. While a precise estimate of costs and a formal cost benefit analysis is not expected, the Board should consider the relative magnitude of costs before deciding whether a standard is cost beneficial. As part of this consideration, the Board should also consider the expected utility of the requirement (a disclosure in this instance), and alternatives for achieving the related objectives. In this instance, it has not been clearly demonstrated that the increased benefits exceed the related costs.

Appendix B: Glossary

[See consolidated Glossary in Appendix E of this document.]

Appendix C: Examples of Fiduciary Note Disclosure

1. Example of Fiduciary Note Disclosure for Federal Component Entity

The following illustrates the summary financial information required in paragraph 18.

Fiduciary Activities

Fiduciary activities are the collection or receipt, and the 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 cash and other assets are not assets of the Federal Government and accordingly are not recognized on the balance sheet.

[Fiduciary Fund A] was authorized by the [*legislation]*, which authorized [*the component entity*] to collect *[type of collections*] on behalf of [*beneficiaries*]. Other fiduciary activities by [*the component entity*] include but are not limited to [*examples of fiduciary activities included in "other."*]

Department XYZ

Schedule of Fiduciary Activity

As of September 30, 2010 and 2009

	2010 Fiduciary Fund A	2010 Other Fiduciary Funds	2010 Total Fiduciary Funds	2009 Fiduciary Fund A	2009 Other Fiduciary Funds	2009 Total Fiduciary Funds
Contributions	$ 233,450	$ 116,550	$ 350,000	$ 200,000	$ 125,000	$ 325,000
Investment earnings	116,725	58,275	175,000	100,000	65,000	165,000
Gain (Loss) on disposition of investments, net	6,670	3,330	10,000	4,000	1,000	5,000
Disbursements to beneficiaries	(300,150)	(149,850)	(450,000)	(200,000)	(150,000)	(350,000)
Increases in fiduciary fund balances	56,695	28,305	85,000	104,000	41,000	145,000
Fiduciary net assets, beginning of year	1,674,000	1,041,000	2,715,000	1,570,000	1,000,000	2,570,000
Fiduciary net assets, end of year	$ 1,730,695	$1,069,305	$2,800,000	$1,674,000	$1,041,000	$2,715,000

Fiduciary Net Assets

As of September 30, 2010 and 2009

	2010 Fiduciary Fund A	2010 Other Fiduciary Funds	2010 Total Fiduciary Funds	2009 Fiduciary Fund A	2009 Other Fiduciary Funds	2009 Total Fiduciary Funds
FIDUCIARY ASSETS						
Cash and cash equivalents	$ 429,895	$ 391,559	$ 821,454	$ 250,000	$ 275,000	$ 525,000
Investments	1,300,000	677,746	1,977,746	1,424,000	766,000	2,190,000
Other assets	1,000		1,000			
Less: Accounts Payable	(200)		(200)			

TOTAL FIDUCIARY NET ASSETS	$ 1,730,695	$1,069,305	$ 2,800,000	$1,674,000	$1,041,000	$2,715,000

2. Example of Note Disclosure for the Government-wide Financial Report

The following illustrates the summary information required in paragraph 27.

Fiduciary Activities

Fiduciary activities are the collection or receipt, and the 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 cash and other assets are not assets of the Federal Government and accordingly are not recognized on the balance sheet. Examples of the Federal Government's fiduciary activities include the Indian tribal and individual Indian trust funds, which are administered by the Department of the Interior, and the Thrift Savings Fund, which is administered by the Federal Retirement Thrift Investment Board.

The following Federal component entities were responsible for fiduciary net assets at September 30, 2010 and 2009. Detailed information is available in the financial statements of the Federal component entities. The Federal component entity websites are listed on page **##** of this document**.**

Schedule of Fiduciary Net Assets

	FY 2010	FY 2009
Department A	$ xxxxx	$ xxxxx
Department B	xxx	xx
Department C	xxxxx	xxxxx
Department D	xxxxxxx	xxxxxxx
All Other	x	x
Total	$ xxxxxxxxxxxxx	$ xxxxxxxxxxxxx

Appendix D: Pro Forma Transactions

Note: The following pro forma transactions illustrate how the information for the fiduciary note disclosure can be recorded in a component Federal entity's financial system utilizing the U.S. Government Standard General Ledger.[20] The approach illustrated utilizes several general ledger accounts that are linked to a note disclosure and not to line items in the principal financial statements. Component entities are also permitted to utilize a separate financial system for fiduciary activities. Transactions and balances that crosswalk to the fiduciary note disclosure are shaded.

Table of Illustrations

Illustration #1 – Federal component entity receives and holds non-Federal party's cash as Fund Balance with Treasury (FBWT).

Illustration #2 – Federal component entity invests non-Federal party's FBWT in Treasury securities.

2A – Federal entity's purchase of Treasury securities on behalf of non-Federal party

2B – Receipt of appropriation by Bureau of Public Debt to pay interest on non-Federal party's Treasury securities

2C – Treasury Bureau of Public Debt pays interest on Treasury securities

Illustration #3 – Federal component entity invests non-Federal party's cash in non-Treasury securities.

3A – Federal entity purchases non-Treasury securities on behalf of non-Federal party

3B – Receipt of interest earned on non-Federal party's non-Treasury securities

[20] Section 803(a) of the Federal Financial Management Improvement Act of 1996 (P.L. 104-208, Division A, Section 101(f), Title VIII) requires Federal agencies to implement the U.S. Government Standard General Ledger (USSGL) at the transaction level. Information about the USSGL can be found on the website of the Treasury Financial Management Service at www.fms.treas.gov/ussgl.

Illustration #4 – Federal component entity disburses interest earned to non-Federal party.

Illustration #5 – Closing entries

Illustration #6 – Effect of pro forma transactions on the Federal Component Entity's Financial Statements.

Illustration #7 – Effect of pro forma transactions on the consolidation worksheet for the U.S. Government-wide financial report.

Illustration #1 – Federal component entity receives and holds non-Federal party's cash.

	DR	CR
Federal Component Entity		
Fiduciary Fund Balance with Treasury (FBWT)	**1,500**	
Fiduciary Collections Received from Beneficiaries		**1,500**
To record fiduciary cash collected.		
Treasury General Fund Entity		
Treasury's Government-Wide Cash Account	1,500	
Treasury General Fund Liability for Fiduciary FBWT		1,500
To record cash received and held by component entity as Fiduciary FBWT.		

Illustration #2 – Federal component entity invests Fiduciary FBWT in Treasury securities.

2A Federal component entity invests FBWT in Treasury securities

Federal Component Entity		
Fiduciary Investments in Treasury Securities	**1,000**	
Fiduciary FBWT		**1,000**
To record fiduciary Treasury securities purchased.		
Treasury General Fund Entity		
Treasury General Fund Liability for Fiduciary FBWT/Component Entity	1,000	
Treasury General Fund's Liability for FBWT/Treasury Bureau of Public Debt		1,000
To record purchase of Treasury securities.		
Treasury Bureau of Public Debt Entity		
FBWT	1,000	
Liability for Fiduciary Treasury securities		1,000
To record sale of Treasury securities.		

2B Treasury Bureau of Public Debt receives an appropriation to fund interest expense

Treasury General Fund Entity

Treasury's Government-wide Cash Account	50	
Transfer-In from Federal Reserve		50
Treasury General Fund receives transfer of Federal Reserve earnings		
Appropriation Warrants Issued	50	
Treasury's Liability for FBWT/Bureau of Public Debt		50
Treasury issues appropriation warrant to the Bureau of Public Debt		

Treasury Bureau of Public Debt Entity

FBWT	50	
Appropriations Received[a]		50
To record appropriation received.		

2C Treasury Bureau of Public Debt pays interest on Treasury securities.

Treasury Bureau of Public Debt Entity

Interest expense	50	
FBWT		50
Unexpended Appropriations- Used	50	
Expended Appropriations		50
To record appropriation received and interest expense paid.		

Federal Component Entity

Fiduciary FBWT	**50**	
Interest revenue/Fiduciary		**50**
To record interest received on fiduciary investments.		

Treasury General Fund Entity

Treasury General Fund Liability for FBWT/Treasury Bureau of Public Debt	50	
Liability for Fiduciary FBWT/Component Entity		50
To record payment of interest by Treasury Bureau of Public Debt		

[a] Note: Accounting for appropriations requires additional budgetary entries that are not displayed here. For additional information, refer to the Treasury Financial Manual Standard General Ledger Supplement at www.fms.treas.gov/ussgl.

Illustration #3 – Federal component entity invests non-Federal party's assets in non-Treasury securities.

3A Federal component entity purchases non-Treasury securities on behalf of non-Federal party

Federal Component Entity		
Fiduciary Investments in non-Treasury securities	**500**	
Fiduciary Fund Balance with Treasury		**500**
To record securities purchased on behalf of non-Federal parties.		

Treasury General Fund Entity		
Treasury's Liability for Fiduciary FBWT/Component Entity	500	
Treasury's Government-wide Cash Account		500
To record cash withdrawal.		

3B Interest is received on non-Treasury securities and held as FBWT

Federal Component Entity		
Fiduciary FBWT	**10**	
Interest Revenue/Fiduciary		**10**
To record interest received on fiduciary investments held outside of the U.S. Treasury.		

Treasury General Fund Entity		
Treasury Government-wide cash account	10	
Treasury General Fund Liability for Fiduciary FBWT/Component Entity		10
To record cash received and deposited as fiduciary FBWT.		

Illustration #4 – Federal entity disburses interest earned to non-Federal beneficiaries

4. **Disbursement to beneficiaries of interest earned.**

Federal Component Entity		
Fiduciary Disbursements to Beneficiaries	**50**	
Fiduciary FBWT		**50**
Payment made to beneficiaries.		
Treasury General Fund Entity		
Treasury General Fund Liability for Fiduciary FBWT/Component Entity	50	
Treasury's Government-wide Cash Account		50
To record cash withdrawal.		

Illustration #5 – Closing Entries for Pro Forma Transactions Illustrated

Pre-closing trial balances after pro forma transactions:

	Component Entity	Treasury GF	Treasury BPD
Assets			
Fiduciary FBWT	**10**		
FBWT (Non-Fiduciary)			1,000
Government-wide Cash		1,010	
Fiduciary Investments in Treasury Securities	**1,000**		
Fiduciary Investments in non-Treasury Securities	**500**		
Liabilities			
Liability for Fiduciary FBWT		(10)	
Liability for FBWT		(1,000)	
Liability for Fiduciary Investments in Treasury Securities			(1,000)
Net Position			
Fiduciary Net Assets			
Unexpended Appropriations- Appropriations Received			(50)
Unexpended Appropriations- Used			50
Revenues and Other Financing Sources			
Fiduciary Collections- Contributions from Beneficiaries	**(1,500)**		
Interest Revenue/Fiduciary	**(60)**		
Transfer-In from Federal Reserve		(50)	
Expended Appropriations			(50)
Expenses and Miscellaneous Items			
Interest Expense			50
Fiduciary Disbursements to Beneficiaries	**50**		
Appropriation Warrants Issued		50	
Totals	0	0	0

Closing entries:

Federal Component Entity		
Fiduciary Collections- Contributions from Beneficiaries	**1,500**	
Interest Revenue/Fiduciary	**60**	
Fiduciary Disbursements to Beneficiaries		**50**
Fiduciary Net Assets		**1,510**

Treasury Bureau of Public Debt Entity		
Cumulative Results of Operations	50	
Interest Expense		50
Unexpended Appropriations- Received	50	
Unexpended Appropriations- Cumulative		50
Unexpended Appropriations- Cumulative	50	
Unexpended Appropriations- Used		50
Expended Appropriations	50	
Cumulative Results of Operations		50

Treasury General Fund Entity		
Cumulative Results of Operations	50	
Appropriation Warrants Issued		50
Transfer-In of Federal Reserve Revenue	50	
Cumulative Results of Operations		50

Post-closing trial balances after pro forma transactions:

	Component Entity	Treasury GF	Treasury BPD
Assets			
Fiduciary FBWT	**10**		
FBWT (Non-Fiduciary)			1,000
Government-wide Cash		1,010	
Fiduciary Investments in Treasury Securities	**1,000**		
Fiduciary Investments in non-Treasury Securities	**500**		
Liabilities			
Liability for Fiduciary FBWT		(10)	
Liability for FBWT		(1000)	
Liability for Fiduciary Investments in Treasury Securities			(1,000)
Net Position			
Fiduciary Net Assets	**(1510)**		
Totals	0	0	0

Illustration #6 – Illustration of Federal Component Entity Note Disclosure of Pro Forma Transactions

FEDERAL COMPONENT ENTITY SCHEDULE OF FIDUCIARY ACTIVITY FOR THE PERIOD ENDED SEPTEMBER 30, 20xx		FY 20x2		FY 20x1
Contributions from Beneficiaries		1,500		-
Interest on investments		60		-
Disbursements to Beneficiaries		(50)		-
Increase in Fiduciary Assets		1,510		-
Fiduciary Net Assets, Beginning of Year		-		-
Increase in Fiduciary Assets		1,510		-
Fiduciary Net Assets, End of Year		1,510		-
FIDUCIARY NET ASSETS AS OF SEPTEMBER 30, 20xx				
		FY 20x2		FY 20x1
Cash and Cash Equivalents	$	10	$	-
Investments in Treasury Securities		1,000		-
Other Investments		500		-
Total Net Assets	$	1,510		-

NOTE: The illustration above displays only the impact of the pro forma transactions upon the fiduciary note disclosure. See Appendix C for a more detailed illustration of the fiduciary note disclosure.

Illustration #7 – Effect of Pro Forma Transactions upon Elimination Worksheet for Government-wide reporting

IMPACT ON GOVERNMENT-WIDE ELIMINATION WORKSHEET	Federal Component Entity Note Disclosure	Treasury Bureau of Public Debt	Treasury General Fund	Eliminations	Government-wide Balance Sheet	Government-wide Note Disclosure
ASSETS						
Fiduciary Fund Balance with Treasury	*$ 10*	$ -	$ -	$ -	$ -	*$ 10*
Fund Balance with Treasury	*-*	1,000	-	(1,000)		**-**
Fiduciary Investments in Treasury Securities	*1,000*	-	-	-		**1,000**
Fiduciary Investments in non-Treasury securities	*500*	-	-	-		**500**
Treasury's Government-wide cash account	*-*	-	1,010	-	1,010	
Total assets	*$ 1,510*	$ 1,000	$ 1,010	$ (1,000)	$ 1,010	*$ 1,510**
LIABILITIES						
Treasury's Liability for Fiduciary FBWT	*$ -*	$ -	$ 10	$ -	$ 10	*$ -*
Treasury's Liability for FBWT	*-*	-	1,000	(1,000)		
Treasury BPD Liability for Fiduciary Investments	*-*	1,000	-	-	1,000	
NET POSITION						
Fiduciary net assets	*$ 1,510*	$	-	-		*1,510*
Total liabilities and net position	*$ 1,510**	$ 1,000	$ 1,010	$ (1,000)	$ 1,010	*$ 1,510**

* Note:

- The Federal Component Entity's fiduciary assets, liabilities and net assets (shaded and in italics in the above table) are reported in the fiduciary note disclosure only, and not recognized on the face of the Component Entity's balance sheet or on the Government-wide balance sheet.
- Treasury General Fund liability for fiduciary FBWT is not eliminated.
- Treasury BPD liability for fiduciary securities is not eliminated.
- Note disclosure of fiduciary funds is required at the FR level.

The illustration above displays only the impact of the pro forma transactions upon the eliminations for government-wide reporting. See Appendix C for an illustration of the fiduciary note disclosure.

Appendix E: List of Abbreviations

FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FR	Financial Report of the U.S. Government
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
Treasury BPD	Treasury Bureau of Public Debt
Treasury FMS	Treasury Financial Management Service
U.S.	United States
USSGL	U.S. Government Standard General Ledger

Statement of Federal Financial Accounting Standards 32: Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 “Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government”

Status

Issued	September 28, 2006
Effective Date	For periods beginning after September 30, 2005
Affects	• SFFAS 1, par. 86 • SFFAS 2, par. 56 • SFFAS 3, par. 28, 30, 35, 50, 55, 56, 66, 71, 78, 91, and 109. • SFFAS 5, par. 117 and 121 • SFFAS 6, par. 45, 83, 84, 107 through 111 • SFFAS 7, par. 43, 46, 65.1, and 65.3 • SFFAS 10, par. 35 • SFFAS 18, par, 10 and 11 • SFFAS 59 transitionally amends paragraphs 23 and adds a new paragraph 23A.
Affected by	• SFFAS 42 affects paragraphs 12 and 24.

Summary

This standard amends standards issued prior to January 2003 to specify disclosure requirements appropriate for the Financial Report of the United States Government (CFR) based on the guidance contained in Statement of Federal Financial Accounting Concepts (SFFAC) 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government.*

Table of Contents

Introduction

1. Statement of Federal Financial Accounting Standards 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, issued in January 2003 clarified that all existing and future standards apply to all federal entities unless a standard specifically provides otherwise.

2. This standard amends standards issued prior to January 2003 to specify disclosure requirements appropriate for the Financial Report of the United States Government (CFR) based on the guidance contained in Statement of Federal Financial Accounting Concepts (SFFAC) 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*.

3. Some disclosure requirements contained in previously issued standards have been modified to allow aggregation and reduce detail for government-wide reporting while other disclosure requirements have been eliminated because of excessive detailed information required that is inappropriate for a government-wide report consistent with the guidance contained in SFFAC 4.

4. Appendix B provides a non-authoritative summary of the effect of these changes on disclosure requirements. It presents amended text of existing standards and related new requirements in a table format.

5. This standard also contains CFR disclosure requirements for Note 1 Significant Accounting Policies.

Scope

6. This statement provides financial accounting standards for the CFR. It does not change financial accounting standards for component entity reports.

Effective Date

7. This standard is effective for periods beginning after September 30, 2005.

Accounting Standard

Amendments to Existing Standards

8. Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, is amended by inserting in par. 86 the following final sentence – "The U. S. government-wide financial statements need not include this disclosure."

9. SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, par. 56 is amended by inserting the following final sentence – "The U. S. government-wide financial statements need not include this disclosure."

10. SFFAS 3, *Accounting for Inventory and Related Property*, is amended as follows:

    a. The text "The above listed disclosure requirements are not applicable to the U. S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities." is added following the existing text of these paragraphs: Par. 28, 35, 50, 56, 66, 78, 91, and 109.

    b. The text "The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected net realizable value." is added to par. 30 as the final sentence.

    c. The text "The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price." is added to par. 55 as the final sentence.

    d. The text "The U.S. government-wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions." is added to par. 71 as the final sentence.

11. SFFAS 5, *Accounting for Liabilities of the Federal Government*, is amended as follows:

    a. The text "The U.S government-wide financial statements need not follow the required disclosures described below." is added to par. 117 as the final sentence.

    b. The text "The U.S. government-wide financial statements need not separately report or disclose all components of the liability for future policy benefits with a description of each amount and an explanation of its projected use and any other potential uses." is added to par. 121 as the final sentence.

12. SFFAS 6, *Accounting for Property, Plant, and Equipment*, is amended as follows:

a. The text “The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.” is added following the existing text for par. 45.

b. [Rescinded by SFFAS 42.]

c. [Rescinded by SFFAS 42.]

d. The text “The U.S. government-wide financial statements need not disclose the sources of cleanup requirements.” is added to par. 107 as the final sentence.

e. The text “The U.S. government-wide financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods.” is added to par. 108 as the final sentence.

f. The text “SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E.” is added to par. 109 as the final sentence.

g. The text “The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations.” is added to par. 110 as the final sentence.

h. The text “The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.” is added to par. 111 as the final sentence.

13. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, is amended as follows:

a. The text ”The U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue.” is added to par. 43 as the final sentence.

b. The text “The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements.” is added following the existing text for par. 46.

c. The text “The U.S. government-wide financial statements need not disclose factors affecting collectibility and timing of categories of accounts receivable and the amounts involved.” is added to par. 65.1 as the final sentence.

d. The text “The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax 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. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.” is added to par. 65.3 as the final sentences.

14. SFFAS 10, *Accounting for Internal Use Software*, par. 35 is amended by inserting the text “The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.” is added following the existing text for par. 35.

15. SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, is amended as follows:

a. The text “The U.S. government-wide financial statements need not disclose a reconciliation between the beginning and ending balances of the subsidy cost allowance for the outstanding direct loans and the liability for outstanding loan guarantees reported in the U.S. government-wide financial statements.” is added to par. 10 as the final sentence.

b. The text “The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.” is added following the existing text for par. 11.

Disclosure Requirements Applicable to the U. S. Government-wide Financial Statements

Inventory

16. The U.S. government-wide financial statements should include the following disclosures[1]:

[1] Disclosure is “Reporting information in notes or narrative regarded as an integral part of the basic financial statement.”

a. broad descriptions of inventory categories,

b. a general reference to component entity[2] reports, and

c. balances for each of the following categories of inventory:

1. inventory held for current sale,

2. inventory held in reserve for future sale,

3. excess, obsolete, and unserviceable inventory; and

4. inventory held for repair.

Operating Materials and Supplies

17. The U.S. government-wide financial statements should include the following disclosures:

a. broad descriptions of operating materials and supplies categories,

b. a general reference to component entity reports, and

c. balances for each of the following categories of operating materials and supplies:

1. operating materials and supplies held for use,

2. operating materials and supplies held in reserve for future use, and

3. excess, obsolete, and unserviceable operating materials and supplies.

Stockpile Materials

18. The U.S. government-wide financial statements should include the following disclosures:

a. broad descriptions of stockpile material categories,

[2] 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)

b. a general reference to component entity reports, and

c. balances for each of the following categories of stockpile materials:

1. stockpile materials, and

2. stockpile materials held for sale.

Seized Property

19. The U.S. government-wide financial statements should include the following disclosures:

a. a broad description of seized property, and

b. a general reference to component entity reports.

Forfeited Property

20. The U.S. government-wide financial statements should include the following disclosures:

a. a broad description of forfeited property, and

b. a general reference to component entity reports.

Foreclosed Property

21. The U.S. government-wide financial statements should include the following disclosures:

a. a broad description of foreclosed property, and

b. a general reference to component entity reports.

Commodities

22. The U.S government-wide financial statements should include the following disclosures:

a. a broad description of commodities, and

b. a general reference to component entity reports.

Property, Plant, and Equipment

23. The U.S. government-wide financial statements should include the following *[RSI information: FY 2022-2025] [disclosures: FY 2026]*:

    a. A broad description of PP&E

    b. For general PP&E land

        i. A note on the balance sheet that *[presents RSI: FY 2022-2025] [discloses: FY 2026]* information about general PP&E land and permanent land rights which includes:

            1. A concise statement including a general description of the federal government's land explaining how its federal land relates to the mission of the Federal government.

            2. *[RSI information: FY 2022-2025] [A disclosure: FY 2026]* of estimated acres by predominant use sub-categories and estimated acres of land held for disposal or exchange by the Federal government.

    c. The cost (excluding land and permanent land rights), associated accumulated depreciation, and book value by major class.

    d. A general reference to agency reports for additional information about general PP&E and general PP&E land.

23A. The balance sheet should reference a note that [presents RSI: FY 2022-2025] [discloses the: FY 2026] information[2.1] about general PP&E land and permanent land rights required by paragraph 23, but no asset dollar amounts should be shown. Existing display and disclosures[2.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and information to note disclosures. If general PP&E land and stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

[2.1] Additionally, such information may include a description of the different uses of land managed by the entity, its predominant activities, condition information, and policy initiatives in effect during the reporting period.

[2.2] Existing disclosures at paragraph 23 are those which are in effect for government-wide reporting prior to the amendments contained at paragraph 23.

Deferred Maintenance

24. [Rescinded by SFFAS 42.]

Cleanup Cost

25. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of cleanup cost,

    b. the unrecognized portion of estimated total cleanup costs associated with general PP&E, and

    c. a general reference to component entity reports.

Taxes

26. The U.S. government-wide financial statements should disclose the cumulative cash collections and refunds by tax year and type of tax for the reporting periods.

Direct Loans and Loan Guarantees

27. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of direct loan and loan guarantee programs,

    b. the face value of loans outstanding for direct loan and loan guarantee programs,

    c. the long term cost[3] of loans and guarantees outstanding for direct loan and loan guarantee programs,

    d. net loans receivable for direct loan programs,

    e. the amount guaranteed by the Government for guaranteed loan programs,

    f. the subsidy expense for the reporting year for direct loan and loan guarantee programs, and

[3]"Long-term cost of direct loans and loan guarantees" is the sum of (1) the subsidy cost allowance for post-1991 direct loans, (2) the liability for post-1991 and pre-1992 loan guarantees, and (3) allowance for uncollectible amounts for post-1991 direct loans and loan guarantees.

g. a general reference to component entity reports.

References to Component Entity Reports

28. For each "general reference to component entity reports" required in par. 16 through 27 above, it is required that the preparer indicate, in the relevant note, agencies that are disclosing significant detailed information about the item. Selecting individual agencies to refer readers to requires judgment. The preparer should consider both quantitative and qualitative criteria in selecting such agencies.

Required Note 1 on Significant Accounting Policies Disclosures

29. Describe the reporting entity and identify its major components. Summarize the accounting principles and methods of applying those principles that management has concluded are appropriate for presenting fairly the entity's assets, liabilities, net cost of operations, and changes in net position. Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles. In general, the disclosure should encompass important judgments as to the valuation, recognition, and allocation of assets, liabilities, expenses, revenues and other financing sources. Disclosures of accounting policies should not duplicate details presented elsewhere as part of the notes to the financial statements.

30. In addition, the summary of significant accounting policies should disclose any significant changes in the composition of the reporting entity or significant changes in the manner in which the reporting entity aggregates information for financial reporting purposes. These changes, in effect, result in a new reporting entity, and their impact should be reported by restating the financial statements for all prior periods presented in order to show the new reporting entity for all periods presented.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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---should govern the accounting for specific transactions, events or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background

31. The fiscal year 2003 CFR was discussed by the Board members at the April 2004 FASAB meeting. During the discussion of the FY 2003 CFR, several board members indicated a desire for the CFR to be more accessible to the intended audience identified in SFFAC 4: citizens and citizen intermediaries. The members believed this would require a concise presentation. The member representing the Department of the Treasury (Treasury) agreed and explained that the current CFR omitted certain required disclosures for a variety of reasons. Had these disclosure requirements been included the FY 2003 CFR it would have been much less accessible. The member noted that earlier FASAB standards made no distinction between component entity disclosure requirements and CFR disclosure requirements and to fully comply with all disclosure requirements would further lengthen the CFR.

32. Members agreed that it would be appropriate to review disclosure requirements established prior to the issuance of SFFAC 4 and tailor CFR disclosure requirements to meet the current concepts. This approach has been adopted for standards developed since SFFAC 4 was issued and the Board indicated a willingness to review past standards if resources were not diverted from ongoing projects. Chairman David Mosso asked Treasury to prepare a list of items it does not consider appropriate to the CFR in light of SFFAC 4.

33. At the October 2004 FASAB meeting, the Board considered a proposal prepared by Treasury's Financial Management Service (FMS). The project proposal included a table of items identified for amendment. Based on Treasury's offer to staff the project, the Board agreed to go forward with the project.

Objectives of the Standard

34. At the May 4-5, 2005 FASAB meeting, Board members held a general discussion of the issues associated with the project. SFFAC 4 notes that the CFR has grown in size and complexity and some have questioned whether the CFR is trying to satisfy too many audiences with different needs in one format. SFFAC 4 provides that citizens and citizen intermediaries should be the audience to whom the CFR is primarily directed and it is particularly fundamental that the CFR be timely and understandable to the primary audience.

35. FASAB has been diligent in ensuring that its requirements are consistent with the guidance contained in SFFAC 4 since the January 2003 issuance of SFFAS 24. SFFAS 24 clarified that SFFAS's apply to all federal entities unless a current or subsequent standard specifically provides otherwise. Many earlier SFFAS's were issued without considering the need for less detailed disclosures for the CFR.

36. This SFFAS revisits standards issued before January 2003 and amends many of those standards to specify substitute disclosure requirements for the CFR or eliminate certain requirements. In its deliberations the Board assumed that the disclosures being amended were material disclosures but understood that SFFAC 4 was issued to provide guidance in addressing material items since immaterial items are not required to be reported or disclosed by FASAB standards.

37. The basis for the Board's actions with respect to this SFFAS emanates entirely from the need to implement SFFAC 4 and do retroactively what the Board has done prospectively since January 2003. However, the Board has indicated that disclosure requirements eliminated or modified for the CFR should not result in allowing the preparer to exclude significant unusual items needed to explain changes in balances between years.

38. This standard eliminates or modifies disclosure requirements that are useful for assessing operating performance for a particular program within an agency. For example, disclosures of restrictions on the use of foreclosed property and average holding period for foreclosed property have been eliminated. Also, disclosures of the gross cost associated with exchange revenue and certain pricing policies have been eliminated. If information relevant to assessing operating performance for individual programs were included in the CFR it would not be concise. A concise CFR will be more appealing and therefore more accessible to citizens and citizen intermediaries. The Board believes that including references to other sources of information appropriately balances the appeal of a concise CFR with the disaggregated information necessary to assess operating performance.

39. In general, the specific changes reduce the level of detail provided regarding specific assets and liabilities. Such disaggregated information is inconsistent with SFFAC 4. For readers

seeking additional detail for particular items, the Board proposes to substitute a reference to component entity reports disclosing significant detailed information about the item.

40. Significant accounting policies disclosures are required by this Statement to ensure that the preparer of the CFR informs readers about management's conclusions regarding fair presentation and the basis of such conclusions. This is intended to address concerns about the sufficiency of disclosures in view of the elimination or modification of disclosures that are required for agency level reporting.

Exposure Draft

41. FASAB published the exposure draft (ED) *Consolidated Financial Report of the United States Government Requirements: Implementing SFFAC 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"*, on October 27, 2005. 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*, *JFMIP News,* the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations commenting on past exposure drafts.

42. Twelve letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others	0	6
Auditors	2	1
Preparers and financial managers	3	0

Responses to the ED

43. The majority of the respondents agreed with the proposed changes to the disclosure requirements for the CFR. Additionally, a majority of respondents felt disclosure requirements for component entity reports should be the same as those required in the CFR.

44. Many respondents believed it would be useful to (a) provide a summary report designed for citizen users, (b) develop a central link to agency reports on the website, and (c) study the

needs of citizen users. The Board agrees that these are useful ideas and will consider these suggestions as it prioritizes future work.

45. Specific concerns raised by respondents related to the omission of disclosures of liabilities not covered by budgetary resources, forfeited property not available for sale due to legal restrictions, details regarding modifications to loans and loan guarantees, and the process used by the Financial Management Service to prepare the CFR. The Board did not believe that the concerns outweighed the benefits derived from reducing the disclosures required for the CFR.

Board Approval and Dissent

46. This Statement was approved for issuance by nine members of the Board. Mr. Dacey dissented.

47. Mr. Dacey believes differences in reporting between the CFR and other federal entities should be limited to unique or unusual reporting issues present in the federal reporting environment.

48. Mr. Dacey noted that other accounting standard setters do not differentiate reporting requirements between consolidated and component entities. However, based on materiality, the information presented in consolidated financial statements typically is aggregated and in less detail than in component entity financial statements. Mr. Dacey also noted that FASAB standards reinforce that the standards need not be applied to immaterial items.

49. Mr. Dacey believes that certain information that is (1) required in component entity reports, (2) generally consistent with requirements of other accounting standard setters, and (3) material to the CFR, should be required to be presented in the CFR. Such information, some of which is currently reported in the CFR, relates to disclosure of:

    a. the general composition of and the basis for determining values for inventory, operating materials and supplies, and stockpile materials,

    b. estimated useful lives and depreciation methods for each major class of property, plant, and equipment, and related capitalization thresholds, and

    c. certain credit reform information for material programs, currently reported in the CFR.

50. Based on the Government Accountability Office's analysis, Mr. Dacey believes that the incremental information necessary to report the above information and conform with existing

FASAB standards would likely be nominal in relation to the current CFR (i.e., less than one page).

51. Mr. Dacey notes the “Basis for Conclusions” indicates that if the currently required information was included in the CFR, the CFR would be less accessible to users. In other words, it would lengthen the CFR and make it less appealing to users. However, Mr. Dacey does not believe that the length would be significantly affected. Also, requiring users to locate and read individual entity financial statements to obtain such information would increase the burden on users of the CFR and likely result in the information being less easily accessible to users. While Mr. Dacey strongly supports the notion that financial information about the federal government as a whole should be presented in a manner that appeals to the broadest range of potential users, he feels there are other means to meet this objective. For example, Mr. Dacey noted that several agencies publish brief summary annual reports, in addition to their financial statements, that are intended for broader distribution and are written to be more understandable to a non-financial user.

Appendix B: Relationship of Amendments to New Requirements

The disclosure items addressed by this statement have either been modified to allow aggregation or rescinded to reduce detail for government-wide reporting consistent with guidance contained in Statement of Federal Financial Accounting Concepts 4 “Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government.” (SFFAC 4) For purposes of understanding the impacts of the provisions of this statement, this appendix presents the text of amendments to existing standards along with the text of the new requirements applicable to the CFR.

Relationship of Amendments to New Requirements			
See Par.	Text of Amendment to Existing Standards	See Par.	Summary of Changes
8	The reporting entity should disclose the amount of current liabilities not covered by budgetary resources. <u>The U. S. government-wide financial statements need not include this disclosure.</u> (SFFAS 1.86)		No CFR disclosure would be required.
9	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. <u>The U. S. government-wide financial statements need not include this disclosure.</u> (SFFAS 2.56)	27 and 28	No CFR disclosure would be required regarding modifications of direct loans or loan guarantees. A general reference to agency reports would be provided.

10	The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage; and, (5) the likelihood that a supply of items will be available in the future. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.</u> (SFFAS 3.28) The difference between the carrying amount of the inventory before identification as excess, obsolete, or unserviceable and its net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. <u>The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected net realizable value.</u> (SFFAS 3.30) Disclosures of (1) general composition of inventory; (2) basis for determining inventory values including the valuation method and any cost flow assumptions; (3) changes from prior year's accounting methods if any; (4) balances for each of the following categories of inventory – inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements; (5) restrictions on the sale of material; (6) the decision criteria for identifying the category to which inventory is assigned; and, (7) changes in the criteria for identifying the category to which inventory is assigned. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.</u> (SFFAS 3.35)	16, 28, 29 and 30	The CFR should provide: (1) broad descriptions of inventory categories; (2) a general reference to agency reports that disclose significant detailed information about inventory; and, (3) balances for each of the following categories of inventory – inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

10	Disclosures of: (1) general composition of operating materials and supplies; (2) basis for determining operating materials and supplies values (including valuation method and any cost flow assumptions); (3) changes from prior year's accounting methods, if any; (4) balances for operating materials and supplies held for use, operating materials and supplies held in reserve for future use, and excess, obsolete and unserviceable operating materials and supplies; (5) restrictions on the use of material; (6) decision criteria for identifying the category to which operating materials and supplies are assigned; and, (7) changes in the criteria for identifying the category to which operating materials and supplies are assigned. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.</u> (SFFAS 3.50)	17, 28, 29 and 30	The CFR should provide: (1) broad descriptions of operating materials and supplies categories; (2) a general reference to agency reports that disclose significant detailed information about operating materials and supplies; and, (3) balances for each of the following categories of operating materials and supplies – operating materials and supplies held for use, operating materials and supplies held in reserve for future use, and excess, obsolete and unserviceable operating materials and supplies. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

10	For stockpile materials held for sale, any difference between the carrying amount and their estimated selling price shall be disclosed. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price. (SFFAS 3.55) Disclosures of: (1) general composition of stockpile materials; (2) basis for valuing stockpile materials including valuation method and any cost flow assumptions; (3) changes from prior year's accounting methods if any; (4) restrictions on the use of materials; (5) balances for stockpile materials and stockpile materials held for sale; (6) decision criteria for categorizing stockpile materials as held for sale; and, (7) changes in criteria for categorizing stockpile materials as held for sale. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.56)	18, 28, 29 and 30	The CFR should provide: (1) broad descriptions of stockpile material categories; (2) a general reference to agency reports that disclose significant detailed information about stockpile materials; and, (3) balances for each of the following categories of stockpile materials – stockpile materials and stockpile materials held for sale. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.
10	Disclosures about seized property: (1) explanation of what constitutes a seizure and a general description of the composition of seized property; (2) method(s) of valuing seizures; (3) changes from prior year's accounting methods if any; (4) analysis of change in seized property including the dollar value and number of seized properties that are (a) on hand at the beginning of the year, (b) seized during the year, (c) disposed of during the year, and (d) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seized property and method of disposition where material. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.66)	19, 28, 29 and 30	The CFR should provide a broad description of seized property and a general reference to agency reports that disclose significant detailed information about seized property.

10	Forfeited property that cannot be sold due to legal restrictions but which may be either donated or destroyed shall be subject to the disclosure requirements described below (see paragraph 78). However, no financial value shall be recognized for these items. <u>The U.S. government-wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions.</u> (SFFAS 3.71) Disclosures for forfeited property: (1) composition of forfeited property; (2) method(s) of valuing forfeited property; (3) restrictions on use or disposition of forfeited property; (4) changes from prior year's accounting method if any; (5) analysis of change in forfeited property providing the dollar value and number of forfeitures that (a) are on hand at the beginning of the year, (b) are made during the year, (c) are disposed of during the year and the method of disposition, and (d) are on hand at the end of the year (This information would be presented by type of property forfeited where material.); (6) if available an estimate of the value of property or funds to be distributed to federal state and local agencies in future reporting periods. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities.</u> (SFFAS 3.78)	20, 28, 29 and 30	The CFR should provide a broad description of forfeited property and a general reference to agency reports that disclose significant detailed information about forfeited property.
10	Disclosures when the government acquires foreclosed assets in full or partial settlement of a direct or guaranteed loan: (1) valuation basis used for foreclosed property, (2) changes from prior year's accounting methods, if any, (3) restrictions on the use/disposal of the property, (4) balances in the categories described above (i.e., pre-1992 foreclosed property and post-1991 foreclosed property), (5) number of properties held and average holding period by type or category, (6) number of properties for which foreclosure proceedings are in process at the end of the period. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities.</u> (SFFAS 3.91)	21, 28, 29 and 30	The CFR should provide a broad description of foreclosed property and a general reference to agency reports that disclose significant detailed information about foreclosed property.

10	Disclosures for goods held under price support and stabilization programs (commodities): (1) basis for valuing commodities including the valuation method and any cost flow assumptions; (2) changes from prior year's accounting method if any; (3) restrictions on the use, disposal, or sale of commodities; (4) an analysis of change in the dollar value and volume of commodities, including those (a) on hand at the beginning of the year, (b) acquired during the year, (c) disposed of during the year by method of disposition, (d) on hand at the end of the year, (e) on hand at year's end and estimated to be donated or transferred during the coming period, and (f) that may be received as a result of surrender of collateral related to non-recourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities.</u> (SFFAS 3.109)	22, 28, 29 and 30	The CFR should provide a broad description of commodities and a general reference to agency reports that disclose significant detailed information about commodities.
11	<u>The U.S. government-wide financial statements need not follow the required disclosures described below.</u> Disclosures required by applicable private sector standards: FASB SFAS 60 Accounting and Reporting by Insurance Enterprises, FASB SFAS 97 Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, and FASB SFAS 120 Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts and AICPA Statement of Position (SOP) 95-1 Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises. (SFFAS 5.117)		No CFR disclosure would be required.

11	Additional whole life insurance disclosure required by FASAB: All components of the liability for future policy benefits (i.e., the net level premium reserve for death and endowment policy and the liability for terminal dividends) should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or reducing federal support in the form of appropriations related to administrative cost or subsidies). <u>The U.S. government-wide financial statements need not separately report or disclose all components of the liability for future policy benefits with a description of each amount and an explanation of its projected use and any other potential uses.</u> (SFFAS 5.121)		No CFR disclosure would be required.
12	The following are minimum general PP&E disclosure requirements: (1) the cost, associated accumulated depreciation, and book value by major class; (2) the estimated useful lives for each major class; (3) the method(s) of depreciation for each major class; (4) capitalization threshold(s) including any changes in threshold(s) during the period; and, (5) restrictions on the use or convertibility of general PP&E. <u>The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities.</u> (SFFAS 6.45)	23, 28, 29 and 30	The CFR should provide: (1) a broad description of PP&E; (2) the cost, associated accumulated depreciation, and book value by major class; and, (3) a general reference to agency reports that disclose significant detailed information about PP&E. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

12	At a minimum, the following required supplementary information shall be presented for all PP&E: identification of each major class of asset for which maintenance has been deferred and the 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: (1) description of requirements or standards for acceptable operating condition; (2) any changes in the condition requirements or standards; and, (3) asset condition and a range estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition. If the total life-cycle cost method is used, the following should be presented for each major class of PP&E: (1) the original date of maintenance forecast and explanation for any changes to the forecast; (2) prior year balance of cumulative deferred maintenance amount; (3) the dollar amount of maintenance that was defined by professionals who designed, built, or manage (sic) the PP&E as required maintenance for the period; (4) the dollar amount of maintenance actually performed during the period; (5) the difference between forecast and actual maintenance; (6) any adjustments to scheduled amounts deemed necessary by PP&E managers; and, (7) the ending cumulative balance for the period for each major class of asset experiencing deferred maintenance. <u>The above listed required supplementary information is not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for required supplementary information applicable to the U.S government-wide financial statements for these activities.</u> (SFFAS 6.83) Optional RSI reporting – Stratification between critical and non-critical amounts of maintenance needed to return each major class of asset category to its acceptable operating condition. If management elects to report critical and non-critical amounts, the report shall include management's definition of these categories. <u>The U.S. government-wide financial statements need not separately report stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition as well as management's definition of these categories. SFFAS 32 provides for optional information applicable to the U.S. government-wide financial statements for these activities.</u> (SFFAS 6.84)	24, 28, 29 and 30	The CFR should provide: (1) a broad description of deferred maintenance; (2) amounts for each major asset category (i.e., general property, plant, and equipment, heritage assets, and stewardship land) for which maintenance has been deferred; (3) a general reference to agency reports that report significant detailed information about deferred maintenance; and, (4) optional reporting of the stratification between critical and non-critical amounts of maintenance needed to return each major asset category to its acceptable operating condition. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

12	Disclosures of: The sources (applicable laws and regulations) of cleanup requirements. <u>The U.S. government-wide financial statements need not disclose the sources of cleanup requirements.</u> (SFFAS 6.107) The method for assigning estimated cleanup cost to current operating periods (e.g., physical capacity versus passage of time). <u>The U.S. government-wide financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods.</u> (SFFAS 6.108) For cleanup costs associated with general PP&E, the unrecognized portion of estimated total cleanup costs (e.g., the estimated total cleanup costs less the cumulative amounts charged to expense at the balance sheet date). <u>SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E.</u> (SFFAS 6.109) Material changes in total estimated cleanup costs due to changes in laws, technology, or plans and the portion of the change relating to prior periods. <u>The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations.</u> (SFFAS 6.110) The nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. <u>The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.</u> (SFFAS 6.111)	25, 28, 29 and 30	The CFR should provide: (1) a broad description of cleanup cost; (2) the unrecognized portion of estimated total cleanup costs associated with general PP&E; and, (3) a general reference to agency reports that disclose significant detailed information about cleanup cost. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

13	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 cost 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. The U.S. government-wide financial statements need not break-out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue. (SFFAS 7.43)		No CFR reporting would be required.
13	Each reporting entity that provides goods or services to the public or another Government entity should disclose the following: (1) differences in pricing policy from the full cost or marketing 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; (2) 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; (3) the nature of intra-governmental 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, for disparities between the billing (if any) and full cost; and, (4) 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). The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. (SFFAS 7.46)		No CFR disclosure would be required.
13	Disclosure of factors affecting collectibility and timing of categories of accounts (taxes) receivable and amounts involved. The U.S. government-wide financial statements need not disclose factors affecting collectibility and timing of categories of accounts receivable and the amounts involved. (SFFAS 7.65.1)		No CFR disclosure would be required.

	Disclosure of 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. The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax 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. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements. (SFFAS 7.65.3)	26	The CFR should disclose cumulative cash collections and refunds by tax year and type of tax for the reporting periods.
14	The disclosures required by SFFAS No. 6, paragraph 45, for general PP&E are applicable to general PP&E software. Thus, for material amounts, the following should be disclosed in the financial statements regarding the software: (1) the cost, associated amortization, and book value; (2) the estimated useful life for each major class of software; and (3) the method(s) of amortization. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 10.35)	23, 28, 29 and 30	The CFR should provide: (1) the cost, associated accumulated depreciation, and book value; and, (2) a general reference to agency reports that disclose significant detailed information about PP&E. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

15a	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 (interest subsidy cost, the default cost, the present value of fees and other collections, and other subsidy costs) for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy re-estimates as defined in paragraph 32 (i.e., the subsidy cost allowance for direct loans and the liability for loan guarantees), 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. <u>The U.S. government-wide financial statements need not disclose a reconciliation between the beginning and ending balances of the subsidy cost allowance for the outstanding direct loans and the liability for outstanding loan guarantees reported in the U.S. government-wide financial statements.</u> (SFFAS 18.10)	28	No reconciliation is required in the CFR. A general reference to agency reports would be provided.

15b	Disclosure and Discussion Requirements: (A) Reporting entities should provide a description of the characteristics of programs and 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 recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy re-estimates by components 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 re-estimates. 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. (D) The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 18.11)	27, 28, 29 and 30	The CFR should provide: (1) a broad description of direct loan and loan guarantee programs; (2) the face value of loans outstanding for direct loan and loan guarantee programs; (3) the long term cost of loans (e.g, the subsidy cost allowance for post-1991 direct loans and the allowance for uncollectible amounts for pre-1992 direct loans) and guarantees (e.g, the liability for loan guarantees) outstanding for direct loan and loan guarantee programs; (4) net loans receivable for direct loan programs; (5) amount guaranteed by the Government for guaranteed loan programs; (6) the subsidy expense for the reporting year for direct loan and loan guarantee programs; and, (7) a general reference to agency reports indicating agencies that are disclosing significant detailed information about direct loan and loan guarantee programs. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

Appendix C: List of Abbreviations

CFR	Consolidated Financial Report of the United States Government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FMS	Financial Management Service (Treasury)
FY	Fiscal Year
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Statement of Federal Financial Accounting Standards 33: Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates

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Affects	• SFFAS 5. pars. 65, 66, 83, 95, and 157. • SFFAS 7, par. 67.1 and 67.2. • SFFAS 17, pars. 25, 27(2), and 27(4). • Interpretation 3 was rescinded by par. 36.
Affected by	None.

Summary

During its consideration of long-term obligations, the Board discussed the need to highlight gains and losses from changes in assumptions in federal financial reports. Some of the most significant changes in amounts on the statement of net cost for the consolidated Financial Report of the United States Government (CFR) and for certain component entities can result from gains and losses from changes in assumptions. This Statement addresses that need.

This Statement applies to federal entities that report liabilities and expenses for federal employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB) in general purpose financial reports prepared pursuant to Federal Accounting Standard Advisory Board standards.

This Statement requires gains and losses from changes in long-term assumptions used to estimate federal employee pension, ORB, and OPEB liabilities to be displayed on the statement of net cost separately from other costs. Separate display will provide more transparent information regarding the underlying costs associated with these liabilities.

This Statement also requires disclosure of the components of the expense associated with federal employee pension, ORB, and OPEB liabilities in notes to the financial statements. Such disclosure will provide useful information for analysis. The information will be comparable across agencies and between postemployment and retirement programs.

This Statement also provides a standard for selecting the discount rate assumption for present value estimates of federal employee pension, ORB, and OPEB liabilities. There is currently uncertainty in practice in this regard.

This Statement also provides a standard for selecting the valuation date for estimates of federal employee pension, ORB, and OPEB liabilities, which will establish a consistent method for such measurements.

Table of Contents

Introduction

Purpose

1. This statement requires the following:

   a. Gains and losses from changes in **long-term assumptions**[1] used to estimate federal employee pension, **other retirement benefit** (ORB), and **other postemployment benefit** (OPEB) liabilities should be displayed on the statement of net cost separately from other costs. This display will provide more transparent information regarding the underlying costs associated with certain liabilities.

   b. Components of the expense associated with federal employee pension, ORB, and OPEB liabilities should be disclosed in notes to the financial statements. Such disclosure will provide information useful for analysis. The information will be comparable across agencies and between postemployment and retirement programs.

2. This statement also provides standards for selecting:

   a. The discount rate assumption for pension, ORB, and OPEB liabilities. There is currently uncertainty in practice regarding the selection of discount rates in some situations.

   b. The valuation date for measuring pension, ORB, and OPEB liabilities, which will establish a consistent method for such measurements.

Background

Reporting Gains and Losses from Changes in Assumptions

3. During its discussions of long-term obligations the Board addressed the need to highlight certain gains and losses from changes in assumptions in federal financial reports. Some of the most significant changes in amounts on the statement of net cost for the consolidated Financial Report of the United States Government (CFR)[2] and for certain **component entities** can result from gains and losses from changes in assumptions. The Board is now

[1] Terms in the Glossary are shown in **boldface** the first time they appear in this document.

[2] See Appendix D containing Note 11, "Federal Employee and Veterans Benefits Payable," from the FY 2006 CFR.

requiring that such gains and losses be reported as a discrete line item on the statement of net cost.

Selecting the Discount Rates

4. SFFAS 5 provides standards for several types of liabilities, some of which require present value valuations. Federal accounting standards requiring present valuations usually specify U. S. Treasury borrowing rates as the discount rates, although the terminology used differs.

5. With respect to the selection of assumptions for pension, ORB, and OPEB liabilities, including the discount rate assumption, SFFAS 5 emphasizes expected long-term future trends rather than recent past experience. For the discount rate, SFFAS 5 required either the entity's long-term investment yield on assets, if the benefit plan is being funded, or other long-term assumptions such as Treasury borrowing rates for securities of similar maturity to the period over which the payments are to be made.[3]

6. Some entities interpreted the SFFAS 5 standard with respect to **other postemployment benefits** (OPEB) to require the use of single-day Treasury rates for the discount rates. Single-day rates render liability projections susceptible to more volatility than, for example, rates based on long-term expectations or historical experience.

7. Liabilities for postemployment and retirement benefits can be very large. The combination of the magnitude of these liabilities and volatility of the projections has resulted in large variations in annual cost from year to year that reduces the usefulness of reported operating results.

8. FASAB standards that require the use of Treasury borrowing rates for discounting do not specify a precise method for selecting such rates. There were a number of options for the discount rate. However, the discount rate generally required in FASAB standards is the rate on **marketable Treasury securities** of similar maturity to the cash flows of the obligation in question.

9. This Statement provides a standard for selecting discount rates for present value measurements of federal employee pension, ORB, and OPEB liabilities.

[3]SFFAS 5, pars. 66, 83, and 95.

Selecting the Valuation Date

10. This Statement provides a standard regarding selecting valuation dates for present valuations of federal employee pension, ORB, and OPEB liabilities. Few FASAB standards currently address the valuation date per se.

11. In Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997), the Board addressed the valuation date issue with respect to measuring federal civilian and military employee pension and retirement health care liabilities in general purpose financial reports prepared pursuant to SFFAS 5. Interpretation 3 requires that pension and retirement health care liabilities in general purpose federal financial reports prepared pursuant to SFFAS 5 be measured as of the end of the reporting period. However, a full actuarial valuation as of the end of the reporting period is not required. The Interpretation allows the measurement to be based on an actuarial valuation performed as of an earlier date during the fiscal year, including the beginning-of-year, adjusted or "rolled forward" for the effects of changes during the year in major factors such as pay raises and cost of living adjustments.

12. In this Statement the Board is extending the Interpretation 3 approach to expense and liability measurement for OPEB liabilities.

13. This Statement is effective for fiscal years beginning after September 30, 2009.

Accounting Standard

Scope

14. This Statement applies exclusively to entities that report liabilities for federal employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB), including veterans' compensation,[4] in general purpose financial reports prepared pursuant to Federal Accounting Standard Advisory Board (FASAB) standards. This Statement does not apply to the Federal Employees Compensation Act (FECA) program.

15. This Statement requires the display of gains and losses from changes in long-term assumptions used to estimate liabilities for federal employee pensions, ORB, and OPEB, including a discount rate assumption. For the purpose of this Statement, assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, the entire series should be considered the event and, thus, projected payments may commence within one year but would be required to extend at least five years. Otherwise, assumptions would be considered short-term.

16. This Statement does not preclude entities from displaying or disclosing any information about the effect of changes in any assumptions with regard to other types of activities.

17. In addition, except for the change in terminology to characterize the preparer's "best estimate" as "reasonable estimate," this Statement does not apply to social insurance programs for which the FASAB has specifically provided standards in SFFAS 17, *Accounting for Social Insurance*. The preparation and display of the expense and liability, related disclosures, and the statement of social insurance follows the standards promulgated in SFFASs 17, 25,[5] and 26.[6]

[4] The pension program for veterans of the Department of Veterans' Affairs (DVA) is not accounted for as a "federal employee pension plan" under SFFAS 5 and the obligation therefore is not recorded as a liability due to differences between its eligibility conditions and those of federal employee pensions. The veterans' pension obligation is currently measured internally by the DVA in a manner consistent with the DVA's compensation program.

[5] *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessments*, July 17, 2003.

[6] *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, November 1, 2004.

18. This Statement applies to information provided in general purpose federal financial reports. It does not affect statutory or other special-purpose reports, such as pension or ORB reports.

Display

Component Entities

19. Component entities should display gains and losses from changes in long-term assumptions used to measure liabilities for federal civilian and military employee pensions, ORB, and OPEB, including veterans' compensation, as a separate line item or line items on the statement of net costs. See the pro forma illustration in Appendix B.

20. Selecting the gains and losses to display from changes in individual pension, ORB, and OPEB liability assumptions to be displayed on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from the gain or loss and the size of the gain or loss relative to the liability; and qualitative factors including whether the gain or loss would be of interest to decision-makers and other users. Nothing in this standard should be construed to preclude an entity from displaying gains or losses from changes in short-term assumptions.

21. Pursuant to SFFAS 5, some component entities report the liability and expense for pensions, ORB, or OPEB, while other component entities report only **normal (or service) cost**.[7] The Office of Personal Management is an example of the former with respect to the Federal Employees Retirement System (FERS), and federal component entities with employees participating in FERS are examples of the latter. Component entities that report pension, ORB, or OPEB liabilities should display a discrete line item for gains and losses from changes in assumptions on its statement of net cost when the conditions in paragraphs 19-20 above are met. Component entities reporting only the normal or service cost should not display such gains and losses.

[7]The terms “employer entity” and “administrative entity” are used in SFFAS 5 to distinguish between entities that employ federal workers and thereby incur the employee costs, including pension cost, and those that are responsible for managing and/or accounting for the pension or the other employee plan. For example, entities that receive “salaries and expense” appropriations are employer entities, while the Office of Personnel Management (OPM) is an administrative entity because it administers the civilian retirement benefit plans. See especially SFFAS 5, pars. 71-2 and 88. An entity may be both an employer entity and an administrative entity, for example, when it, rather than OPM, administers a pension plan for its employees. In such instances, that entity would be responsible for reporting gains and losses from changes in assumptions if the conditions in paragraph 19-20 are satisfied.

22. Component entities should disclose in notes to the financial statements the following reconciliation of beginning and ending pension, ORB, and OPEB liability balances:

Beginning liability balance	$X,XXX
Expense:	
Normal cost[a]	XX
Interest on the liability balance	XX
Actuarial (gain)/loss: From experience From assumption changes	 XX XX
Prior service costs*	X
Other	(X)
Total expense	XXX
Less amounts paid	(XX)
Ending liability balance	$X,XXX

[a] See the glossary for this standard's definition of "normal cost."

23. This reconciliation must provide all material components of pension, ORB, or OPEB expense consistent with the components identified in the table immediately above, if applicable. Additional sub-components may be presented. The line item for **actuarial gains and losses** should be broken out into the sub-components "from experience" and "from assumptions changes." Significant pension, ORB, and OPEB programs should be presented individually in a separate column along with an "all other" column, if applicable, and a "total" column for each line item.

24. Component entities that report pension, ORB, or OPEB liabilities should disclose the information required in paragraph 22. Component entities reporting only the normal or service cost should not disclose the information required in paragraph 22.

25. Component entities holding non-Treasury securities as assets to fund their pension, ORB, or OPEB programs should disclose the rates of return, specific maturities, and allocation by type (stocks, bonds, etc.) of such assets.

Governmentwide Entity

26. The governmentwide entity should display gains and losses from changes in assumptions as a separate line item or line items on the statement of net cost after a subtotal for all other costs and before total cost. See the pro forma illustration in Appendix B.

27. The governmentwide entity should disclose in the notes to the financial statements a reconciliation consistent with information required in paragraph 22 above for pension, ORB, and OPEB liabilities. At a minimum, reconciliations for liabilities classified as civilian, military, and veterans compensation must be presented. See Appendix C for an example.

Selecting Discount Rates

28. Discount rates as of the reporting date for present value measurements of pension, ORB, and OPEB liabilities should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted. The discount rates should be matched with the expected timing of the associated expected cash flow. Thus, cash flows projected in each period should have a discount rate associated with them. However, one discount rate may be used for all projected future cash flows if the resulting present value is not materially different than the resulting present value using multiple rates. A change to or from multiple rates from or to a single rate should be disclosed.

29. The discount rates as of the reporting date should reflect average historical rates on marketable Treasury securities rather than giving undue weight to the current or very recent past experience of such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The discount rate, the underlying inflation rate, and the other economic assumptions should be consistent with one another.

30. In developing average historical Treasury rates, a minimum of five historical rates as of the reporting date (e.g., at the current and four prior fiscal year ends) should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g., 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of fiscal year 2007 for a payment due in 10 years (i.e., in fiscal 2017), a minimum of the five most recent fiscal year-end historical rates on 10-year Treasury securities should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one of the five historical rates used in the average, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities as of the end of fiscal years 2003 through 2007 would be included in the average.

31. The number of historical rates used in the calculation of the average as explained in paragraph 30, e.g., five fiscal year-end rates, should be consistent from period to period. The entity's accounting policy disclosures should include its policy regarding consistency from one reporting period to the next.

32. In the determination of the historical Treasury rates used, for cash flows that are projected to occur in future years for which Treasury securities are or were not available or that are

expected beyond the maturities at which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate into the determination of the discount rate interest rates interpolated or extrapolated from historical Treasury rates.

Selecting Valuation Date

33. Estimates of pension, ORB, and OPEB liability and expense in general purpose federal financial reports should be measured as of the end of the fiscal year (or other reporting period if applicable). Measurements based on an actuarial valuation may be performed as of an earlier date during the fiscal year, including the beginning of the year, with adjustments for the effects of changes during the year in major factors such as the pay raise and cost of living adjustment. A full actuarial valuation as of the end of the reporting period is not required. Measurements should reflect the entity's assumptions about 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 participants covered (enrollment) that cause a change in the liability.

34. The valuation date in the full actuarial valuation utilized by the entity should be consistently followed from year to year.

Reasonable Estimates

35. The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. The entity's own assumptions about future cash flows may be used. However, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and Product Accounts and, if its assumptions do not reflect such data, explain why it is inappropriate to do so.

Effect on Prior Standards

36. This Statement provides additional requirements for display, disclosure, discount rates, and valuation dates for federal civilian and military employee pensions, ORB, and OPEB in SFFAS 5. Interpretation 3 is rescinded. In addition, this Statement replaces "best estimate" with "reasonable estimate" in SFFAS 5, SFFAS 7, and SFFAS 17.

SFFAS 5

37. This Statement also affects current standards for selecting discount rates. SFFAS 5, *Accounting for Federal Liabilities*, is amended as follows:

*65. **Assumptions**—For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS),~~ the best available~~ actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4,* Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board. Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.* [footnote omitted]

66. In addition to complying with the guidance in the preceding paragraph, **the discount rate assumption for present value measurements of pension liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which cash flows are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates.** ~~the interest rate assumption should be based on an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term Federal government borrowing rate)~~. The underlying inflation rate and the other economic assumptions should be consistent. ~~The rate used to discount the pension obligation should be equal to the long-term expected return on plan assets.~~ **The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. In developing the average historical Treasury rates, a minimum of five historical rates as of the appropriate reporting dates should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g. 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of the fiscal year 2007 for a payment due in 10 years, i.e., in 2017, a minimum of five 10-year Treasury rates should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one rate, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities for the years 2003 through 2007 were included in the average. The number of historical rates used for the average, e.g., five yearly rates, should be consistent from period to period. The entity should explain that its accounting policy is to be consistent in this regard from period to period. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.**

83. ***Assumptions****—Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for* ***federal employee*** *pensions and (2) a* ***long-term*** *health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The* ***discount rate assumption for present value measurements of ORB liabilities should be developed in accordance with paragraph 66 of this standard.*** *~~be equal to the long-term expected return on plan assets if the plan is being funded or on other long-term assumptions (for example, the long-term Federal government borrowing rate) for unfunded plans.~~ The administrative entity should disclose the assumptions used.*

95. The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the ***interest rate on marketable*** *Treasury ~~borrowing rate for~~ securities of similar maturit****ies*** *to the period over which the payments are to be made.* ***The discount rate assumption for present value measurements of OPEB liabilities should be developed in accordance with paragraph 66 of this standard.***

157. Second, assumptions ought to be consistent across federal employee ***pension, other*** *retirement* ***benefit, and other postemployment benefit*** *systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of ~~the best available~~* ***reasonable*** *estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.*

SFFAS 7

38. This Statement also affects current standards that use the term "best estimate." SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, is amended as follows:

> *67.1 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, preassessment work in process. The amounts furnished should represent management's ~~best~~ estimate of additional revenues **reasonably expected** ~~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~~ **reasonable** estimate~~s~~, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.*

SFFAS 17

39. Paragraphs 24-27 and 32-33 of SFFAS 17 provide the standard for required supplementary information (sub-paragraph 27(3) and 32(3) were re-classified as basic information by

SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*). Paragraph 25 of SFFAS 17 is changed as follows:

> *25. The projections and estimates used should be based on the entity's ~~best~~ **reasonable** estimates of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.*

40. Paragraph 27(2) of SFFAS 17 requires the ratio of contributors to beneficiaries as supplementary information. Paragraph 27(2) is changed as follows:

> *27(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. At a minimum, the ratio should be reported for the beginning and end of the projection period*. [footnote omitted]

41. Paragraph 27(4) (a) of SFFAS 17 requires sensitivity analysis as supplementary information. The phrase "best estimate cost" before the word "assumptions" is changed as follows:

> *27(4) (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"~~ **reasonable** cost assumptions as a baseline, show the effect of varying several significant assumptions ….*

Effective Date

42. This Statement is effective for fiscal years beginning after September 30, 2009.

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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Comments Received

A1. The Board did not rely on the number in favor or opposed to a given position. Information about the respondents' 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.

A2. Eight written responses were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		2
Auditors	1	
Preparers and financial managers	5	

Summary of Comments

Display

What the Exposure Draft Proposed regarding Display

A3. During its consideration of long-term obligations the Board discussed how financial statement display might be modified to show the fluctuations in cost caused by changes in assumptions. Some of the most significant changes in amounts on the operating statement for the Financial Report of the United States Government (CFR) and on the statement of net cost for some component entities often result from gains and losses from changes in assumptions. Note 11[8] to the FY 2006 CFR disclosed that the expense for military employee

[8] See Appendix D for Note 11.

pension benefits was $112.2 billion. Of this amount $20.1 billion was for changes in assumptions, and $6.1 billion was from differences between actual experience and what was assumed. And even more dramatically, Note 11 in the CFR for FY 2005 disclosed that of the $123 billion expense for post-retirement healthcare benefit for military personnel, $53 billion was attributed to changes in assumptions and $5 billion was from differences between actual experience and what was assumed.

A4. The issue of volatility in reported annual expense was first brought to the Board's attention with respect to year-to-year volatility in veterans' compensation expense amounts reported by Department of Veteran's Affairs (DVA). Large percentage changes in net cost resulted from DVA's need to estimate future outflow for veteran's compensation benefits based on complex assumptions and cost models. Other agencies need to make similar estimates. Small changes in the discount rate assumption, for example, produce large fluctuations.

A5. The Board decided to propose a general standard rather than focus solely on DVA and other employee compensation liabilities because many programs are affected by changes in long-term assumptions. Although pension, ORB, and OPEB programs employ long-range assumptions to estimate liabilities and periodic expense, other programs also involve long-term assumptions for liability and cost estimates the dollar amounts of which are very large relative to other financial statement items. For example, environmental liabilities require the use of long-term assumptions.

A6. The exposure draft proposed that gains or losses from changes in assumptions, if any, should be presented as discrete line items not assigned to programs on the statement of net cost (SNC). The Board believed that this disaggregation would enhance the usefulness of the information provided on the statement of net cost. Separate display highlights the effects of changes in assumptions, which can be significant. Expenses assigned to programs would be distinguished from the gains and losses from changes in assumptions. The user would be better able to understand the operating performance of the entity as well as the role of gains and losses from changes in assumptions.

A7. The Board believed that the discrete display of such gains and losses would enhance users' understanding of liabilities and periodic expense. Users, including entity managers, would understand more about how liabilities and expense are measured; about the uncertainty of the measurement of individual liabilities; and about what causes changes in liabilities. Managers would benefit from having information about the volatility of assumptions in their programs. Extreme volatility might indicate the assumptions chosen and/or the assumption-selection process needs re-evaluation. Volatility may affect the entity's funding requests and long-term planning. It will at least raise a flag for further investigation.

A8. The proposed Statement provided certain exceptions to the display requirement. Assumptions used to estimate receivables, payables, inventory and related property and other short-term assumptions were excepted because they will be proved or disproved within a relatively short period of time. Also, those assumptions used for direct loans and loan guarantees were excepted because the FASAB has already provided accounting procedures.

Respondents' Comments regarding Display

A9. Most respondents agreed that the separate display of gains and losses from changes in assumptions on the SNC would be informative and useful. One respondent recommended displaying more detail about assumption changes on the face of the SNC, for example, the nature of the assumption change, within a category of assumptions (i.e., economic, demographic, etc.) and the amount of change.

A10. Most of the respondents who commented on the question about the criteria for short – and long-term assumptions found the 5-year criteria useful. One respondent commented that there is some ambiguity in the wording and suggested the following three improvements: (1) explicitly allow display of gains/losses from assumption changes involving estimates for less than five years, (2) include the size of the gain/loss relative to the actuarial liability as part of the guidance in the proposed standard (ED paragraph 21) as another criterion for deciding what to display, and (3) include a discussion of the need to distinguish between benefit changes and assumption changes in the basis for conclusions. Another respondent commented that the glossary should be clearer regarding what is meant by long-term assumptions.

A11. One respondent did not believe the 5-year division is appropriate "to define liabilities." In addition, this respondent thought there would be situations where changes in short-term assumptions could result in material gains and losses.

A12. Another respondent commented that the proposed standard did not provide satisfactory guidance based on their belief that it (1) would apply to a very limited federal audience, (2) uses high-level generalities, and (3) should be directed to the administrative entities for the primary federal employee benefit programs.

A13. Several respondents commented that the proposed standard is not clear with respect to how it applies to non-actuarially prepared liability estimates. For example, one respondent thought that it may not be feasible to identify separate components of an annual change in non-actuarial liabilities. Another respondent asked for more guidance with respect to paragraph 21 in the exposure draft, which directed the preparer to use judgment in selecting the long-term assumptions for which gains and losses from changes are to be displayed individually on the statement of net cost.

The Board's Conclusions regarding Display

A14. The Board decided to limit the standard to federal employee pension, ORB, and OPEB liabilities. This decision is based on the Board's desire to address more immediately its primary concern, which is to display the effect of assumption changes on employee compensation liabilities. The Board considered the requests from some respondents for more guidance regarding how the standard would apply to other than pension, ORB, and OPEB activities. Although in principle a broader application is desirable, the Board believes that developing additional guidance would significantly delay implementation of a broad standard. Therefore, the Board concluded that limiting the scope to pension, ORB, and OPEB liabilities would address the specific issue presented at this time. In addition, the need for information about the effect of assumption changes is more acute for pension, ORB, and OPEB liabilities than for other liabilities where the combination of factors that the preparer would have to consider is more complex. Legal contingencies, for example, involve an array of considerations that are not as clear-cut as for employee benefits.

A15. This decision effectively renders moot several of the respondents' concerns. First, it addresses the concern of some respondents that the guidance was not specific enough with respect to which assumptions are subject to the standard. Second, it addresses the concern that the disclosure requirement of ED paragraphs 22-23 were too pension-oriented and preparers may be confused regarding how to classify annual changes in, for example, environmental cleanup liabilities or contingent liabilities.

A16. Narrowing the scope of the standard also meant that the examples of liabilities to which the standard does not apply were not necessary. Paragraph 14 now explicitly states that the standard applies exclusively to pensions, ORB, and OPEB. The Board decided that the ED paragraphs containing examples of other liabilities to which the standard would not apply (e.g., liabilities that employ long-term assumptions where the FASAB has specifically provided standards such as loans and loan guarantees, or to assumptions that are short-term in nature, including estimates or receivables, payables inventory, and claims incurred but not reported) were redundant and potentially confusing, and they have been removed.

A17. With respect to concern that the proposed standard did not provide satisfactory guidance regarding how it applies to administrative and employer entities as defined in SFFAS 5, specific guidance has been added. The standard now states that, in cases where an entity does not report the pension, ORB, or OPEB liability, that entity is not responsible for reporting gains and losses from changes in assumptions. For example, most civilian federal employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS) pension plans, which are administered by the Office of Personal Management (OPM). Federal reporting entities whose employees participate in CSRS and FERS (other than OPM itself) report only a portion of the annual cost of the employee benefits. This portion is called the "normal cost" (or, "service cost'). The OPM reports the liability and all costs components, as described in SFFAS 5. Thus, the OPM, which is called the "administrative agency" in SFFAS 5, is responsible for reporting the gains and losses from changes in assumptions as a discrete line item on its SNC.

A18. An entity may function both as an employer and an administrator entity. For example, it may administer a pension benefit for its employees rather than participate in CSRS or FERS. In such instances, that entity would report the liability and all costs. Thus, that entity would report gains and losses from changes in assumptions, if the conditions in paragraphs 19-20 are satisfied. The Board believes that the display of the effect of changes in assumptions will be meaningful for all entities that report a pension, ORB, or OPEB liability.

A19. The Board considered the applicability of this standard to the Federal Employees Compensation Act program. The Board concluded that it was not appropriate or necessary for the Department of Labor to provide the information concerning gains and losses from changes in assumptions to the employer agencies, nor for the employer agencies to separately report or disclose such information. Under the particular circumstances of FECA accounting and reporting, the Board decided that the value of the FECA information provided pursuant to this standard would not offset the burden and cost of providing it.

A20. Regarding the distinction between "short-term assumptions" and "long-term assumptions," the Board believes the standard provides sufficient guidance. Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, the entire series should be considered the event and, thus, projected payments may commence within one year but would be required to extend at least five years. Otherwise, assumptions would be considered short-term. The Board believes that limiting the scope of the standard to federal employee pensions, ORB, and OPEB will reduce the potential for misunderstanding.

A21. Regarding the comment that information about changes in short-term assumptions might be informative, the Board agrees that there might be instances where the display of gains and losses from changes in assumptions that are by definition "short-term" in nature might be informative. Although it does not require such display, the final standard does not preclude displaying the effect of changes in short-term assumptions (see paragraph 16).

A22. Regarding the comment about the propriety of the 5-year criteria for distinguishing long-term liabilities, the proposed standard did not define "long-term liabilities." It used that term generally to describe the types of liabilities for which components of expense should be disclosed and for which estimates are undertaken using "long-term assumptions." The proposed standard defined long-term assumptions as those where the underlying event about which the assumption is made will not occur for five years or more. The Board understands the respondent's comment to involve a question about the sufficiency of the general usage of "long-term liability" in the standard. The Board believes that the usage of "long-term liability", along with the specific focus on assumptions involving events of 5 years or more, is sufficient. However, in order to make the standard as clear as possible, in the final standard the Board uses the word "long-term" primarily to modify the word "assumption" and does not apply it to the word "liability." Rather, the standard refers to liabilities and/or estimated liabilities that involve long-term assumptions.

Note Disclosures

What the Exposure Draft Proposed regarding Disclosure

A23. The proposed standard required certain note disclosures. First, the components of expense associated with liabilities involving long-term assumptions were to be disclosed. The Treasury Department and other users advocated a disclosure that will allow increased comparability between federal civilian and military employee and veteran benefits programs. The Board believed that disclosing the components of expense will provide information about the government's annual accrued costs and about increases and decreases in the associated liability that will be useful for decision-making. The Treasury Department prepares the CFR and must explain any wide swings in certain liabilities. For some time Treasury has sought to improve the disclosure for federal employee and veteran benefits payable and currently discloses the information shown in Appendix D. The desire for more transparency in this regard is not only the goal of the Treasury Department but also apparent in comments from other CFR users, most notably the Federal Reserve. Most of the information required in this Statement is already presented in the CFR but some data is missing. The proposed standard was intended to fill these gaps.

A24. In addition to the components of expense, the exposure draft proposed disclosure of market rates for Treasury securities with 10-, 20-, and 30-year maturities. The Board believed that market rates would be a useful benchmark for comparison with the discount rate(s) the entity is using. The discount rate affects expense and liability amounts and a comparison with market rates would provide useful context. The Board considered but decided not to require the note disclosure to include the entity's analysis of the effect on expense and liability amounts of using current market rates. The burden of such a requirement on some preparers was deemed to outweigh the benefits of the information provided. However, the proposed note disclosure would allow interested parties to begin such an analysis.

Respondents Comments regarding Disclosure

A25. Most respondents commented that the note disclosure would be informative. One respondent recommended more detailed information about gains and losses from assumption changes. For example, display the type of assumption within a category of assumptions (i.e., categories are economic, demographic, discount rates, etc.) and the amount of each change. Another respondent recommended disclosure of (1) the assumed rate of return on the plan assets, if the reporting entity has such assets – that is, not just the return on Treasury securities, (2) the specific maturities for the Treasury securities, and (3) the allocation of the fund's assets by asset general category. Another respondent recommended requiring the reporting entity to determine its financial position using both the discount rate on Treasury securities and the discount rate on the actual assets of the fund, if any, to show the actual impact of these different rates.

A26. Another respondent commented that the disclosure would be neither meaningful nor informative. They found the standard too vague to determine whether long-term construction contacts or procurements would be included. They cited issues involving their Standard General Ledger accounts and accounting system.

A27. One respondent commented that the disclosure of market rates would be informative and provide transparency. However, another respondent found the benchmark comparisons unnecessary and potentially confusing. This respondent favored merely stating the basis for selecting assumptions in the notes; for example, that a board of experts decided the rates are appropriate.

A28. One respondent commented that the proposed standard appeared to eliminate the requirement in SFFAS 5, par. 88, for disclosure of gains and losses due to changes in the medical trend assumptions as a separate item because it could be included in disclosure of all other such gains and losses. The Board notes that this is not the case; the requirement in par. 88 is not affected by this standard.

The Board's Conclusions regarding Disclosure

A29. With respect to the suggestion that more detail be disclosed, the proposal in the exposure draft did not require as much detail on the face of the financial statement or as much disclosure as recommended by some respondents. The Board's decision to limit the scope of the final standard to pensions, ORB, and OPEB reduces the need for additional detail. At the same time the Board added a requirement for disclosure of information about non-Treasury assets, if any. As noted above, the exposure draft did not and the standard does not preclude display or disclosure of short-term gains and losses or other material components.

A30. Regarding the comments about disclosing current market rates for certain Treasury securities, the Board decided to eliminate this requirement. Some believe that this disclosure would be a useful benchmark for comparison with the discount rate used by the entity. They note that current market rates are used in many other contexts. Moreover, others believe that the current market rate for Treasury securities is the best indicator of the government's borrowing cost. However, others question the usefulness of the disclosure for several reasons. First, they note that the exposure draft did not require the entity to provide an analysis of the effect of using current market rates on the entity's liability and periodic cost, because the Board concluded that the benefit of such an analysis was outweighed by the burden of producing it. Second, the entity was not required to disclose the average historical Treasury rates it was using for discounting and therefore a direct comparison would not be possible. Finally, some believe that the disclosure is not a good benchmark because the Board is requiring another discount rate; and, if a benchmark were to be disclosed, it should be closer to what the Board is requiring. The Board decided that, given the lack of unanimity on its information value, the disclosure should not be required.

A31. Similarly, a respondent recommended using both the discount rate on Treasury securities and the discount rate on the actual assets of the fund, if any, to show the impact of these different rates. The Board believes this disclosure would be informative but concluded that its informational value did not clearly overcome the burden that preparing two calculations would have imposed on the preparer, and therefore reporting such information should be optional.

A32. Regarding the request for more guidance about administrative and employer entities, the standard now explains that, as indicated in paragraphs A17-A18 above, the entity that reports the pension, ORB, or OPEB liability should display the gains or losses from changes in assumptions and disclose the relevant liability components.

Selecting Discount Rates

What the Exposure Draft Proposed regarding Discount Rates

A33. The Board became aware of an issue affecting preparers with respect to the selection of discount rates for present value measurements of expense and liability amounts. A preparer noted that, with respect to OPEB accounting, SFFAS 5 requires that the liability be estimated using as the discount rate the U. S. Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.[9] The preparer asked whether the discount rates should be based on a single day's interest rates, or were other alternatives acceptable, such as an average of interest rates over a period of time. The preparer currently uses one-day Treasury "spot" rates consistent with the expected timing of future cash flows relating to the program, believing that that is what the Board intended by the standard in SFFAS 5, paragraph 95. As a result, its liabilities have been susceptible to extreme volatility.

A34. Several current FASAB standards require present valuations and discounting. For example, federal civilian and military employee pensions, ORB, OPEB, including veterans' compensation, require discounting. Federal activities that incur such liabilities typically involve similar types of demographic and economic assumptions.

[9] SFFAS 5, par. 95.

A35. The FASAB standard for federal civilian and military employee pensions and ORB includes general guidance with respect to assumptions.[10] These standards state that federal pension plans should be guided by Actuarial Standards of Practice (ASOP), e.g., ASOP 4, *Measuring Pension Obligations*, and ASOP 27, *Selection of Assumptions for Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board (ASB). The ASB is a board associated with the American Academy of Actuaries that sets professional standards of actuarial practice in the United States. The Board referenced ASB standards because it considers them accepted actuarial practice.

A36. Consistent with ASOPs, SFFAS 5, paragraph 65 requires actuarial assumptions to be based on the actual experience of the covered group and to emphasize expected long-range future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the standard requires that the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.

A37. With respect to discount rates for pension and ORB accounting, SFFAS 5 requires the interest rate used for discounting to be based on

> an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term federal government borrowing rate). …[11]

A38. The FASAB standard for OPEB differs somewhat from that for pensions and ORB. For OPEB, SFFAS 5 requires employer entities to estimate the amount and timing of future payments and to discount the future cash flows using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.[12] This difference is attributable to the fact that, unlike most federal civilian and military employee pension and ORB plans, the federal employee OPEB generally are not funded and thus the long-term yield on investments was not thought to be relevant. For plans that are not funded the standards have been essentially the same: the objective is an expected long-term rate that reflects the government's expected borrowing costs.

A39. The Board concluded in SFFAS 5 that the discount rate for pensions and ORB, which are funded, should reflect the long-term expected return on plan assets. The Board explained

[10] See SFFAS 5, pars. 65 and 83, respectively, for pensions and ORB.

[11] SFFAS 5, par. 66.

[12] SFFAS 5, par, 95.

that the expected long-term rate reduces volatility, reflects the actual experience and expectations of the primary federal plans, and is consistent with the assumptions used in the budget.[13]

A40. As previously stated, current FASAB standards provide two approaches for selecting discount rates. The first approach is the expected long-term return on plan assets. The second approach involves unfunded plans where an expected long-term return on plan assets is not available and a Treasury borrowing rate is required. The proposed standard employed one approach for all instances not otherwise expressly provided in FASAB standards: discount rates for present value measurements of estimated liabilities that involve long-term assumptions should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the benefit payment for which the estimate is being made.

A41. The Board believed that discount rates for present value measurements of expense and liability amounts should be average historical rates for marketable Treasury securities because they reflect the government's borrowing cost with the public. Also, expected long-term rates reduce volatility, reflect the actual experience and expectations of the primary federal plans, and are consistent with the assumptions used in the budget.

A42. The proposed standard eliminated the plan's investment yield as an option for discount rates for present value measurements of expense and liability amounts. The discount rate assumption for liabilities is used most significantly to calculate the present value of the obligation and the **annual cost increments** of net periodic cost, for example, the normal cost component of pension expense. Both of those uses are conceptually independent of a plan's assets, if any. If two employers have made the same benefit promise, the FASAB believes the annual cost increments and the present value of the obligation should be the same even if one expected to earn an annual return of 6 percent on its plan assets and the other had an unfunded plan.

A43. The Board noted that the Pension Protection Act of 2006[14] requires fund managers to focus on long-term interest rates instead of their particular asset holdings. The Act requires them to calculate pension liabilities based on current bond rates rather than the expected rate or return from an asset portfolio. Thus, high expected gains from stock holdings will no longer be able to help diminish benefit liabilities since they will no longer be part of the calculation.

[13] SFFAS 5, par. 159.

[14] PL No. 109-280.

A44. The FASAB believes that the objective of discount rates is to reflect **the time value of money**. The time value of money should reflect the single amount that, if invested at the measurement date in risk-free investments with maturities like those of the future benefit payments being measured, would generate the necessary cash flows to pay the benefits when due. Marketable U.S. Treasury securities are deemed risk free because they pose neither uncertainty in timing nor risk of default to the holder. This single amount is the gross liability. It would equal, conceptually, the current market value of a portfolio of Treasury zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. In the absence of a portfolio of such zero coupon Treasury securities, however, the federal preparer should incorporate in assumed discount rates the re-financing rates expected to be available on marketable Treasury securities in the future, which should be extrapolated from historical experience.

A45. With respect to Treasury rates the Board considered average historical rates as well as current market rates as of the reporting date. Some prefer current market rates, arguing that interest rates can move significantly from year to year and the use of interest rates from a prior year (or smoothing this year's rates with those from prior years) can therefore result in significant misstatements about the current value of future cash flows. They argue further that changing interest rate assumptions annually would result in more accurate but also more volatile estimates of liabilities and changes in net cost than the current actuarial practice in the federal government of revisiting interest rate assumptions every 3 to 5 years. They argue that the proposed display standard is the best way to deal with volatility, i.e., by reporting on a separate line changes in net cost due to changes in actuarial assumptions.

A46. The FASAB decided to propose average historical rates rather than single-day or market rates on the reporting date. The Board believed that single-day rates would not reflect the long-term orientation of most federal programs.

A47. The proposed standard was not intended to change the Board's preference, expressed in SFFAS 5 and elsewhere, for expected future trends rather than giving undue weight to recent past experience. With respect to assumptions in general, FASAB standards have emphasized expected future trends.

A48. Regarding the method of discounting cash flow in future years, the FASAB believed that discount rates used to measure the present value of the annual cost increments of expense should be selected that are applicable to the various benefit periods in question. The Board believed that annual cost increments will be more representationally faithful if individual discount rates applicable to various benefit deferral periods are selected. For future years extending beyond the last for which Treasury rates are available, e.g., beyond 30-year maturities, the proposed standard required the preparer to incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates. However, the proposed standard allowed that a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates, or for cases in which discount rates have limited influence on current liability estimates.

A49. The proposed standard provided for the discount rates to be reviewed at each annual reporting date and changed if materially different from the existing rate. However, the Board preferred a stable discount rate that would result from applying historical averages, rather than current market rates. The Board stated that current market rates produce a degree of volatility that is not a faithful representation of the time value of money in long-term federal programs. The Board also stated that implicit in the notion of stable rates is the fact that the discount rate normally would not change every year. The preparer would change the rate based on a significant change in the historical average Treasury rate, as determined by the preparer, which would reflect long-term expectations rather than the current market rate. Thus, the proposed standard neither required nor precluded annual changes in the discount rate. Current Office of Personnel Management practice is to maintain a constant discount rate for civilian pensions and other retirement benefits for five years. The Board does not anticipate that the proposed standard would necessarily affect that practice because Treasury borrowing rates normally change very slowly.

A50. The discount rate standard in the proposed Statement did not apply to instances where the FASAB has required or permitted a discount rate to capture risk, i.e., to be other than the risk-free Treasury borrowing rate. However, the proposed standard did apply to all instances where risk-free Treasury borrowing rates are appropriate.

Respondents Comments regarding Discount Rates

A51. The majority of respondents commented that long-term Treasury rates are appropriate for discounting liabilities the estimates for which involve long-term assumptions. One respondent favored current market rates over average historical Treasury rates, believing them to be a better reflection of the cost of issuing Treasury securities to extinguish liabilities at the financial statement date. In addition, this respondent believes current market rates would provide more comparability and would be consistent with fair value accounting; but if average historical rates are used, this respondent believes the time period allowed for average historical Treasury rates should be limited to 5 years, which would better reflect the current market than longer horizons.

A52. One respondent commented that it uses statutory rates and that such rates supersede SFFASs.

A53. One respondent found the requirement (ED paragraphs 27 and A33) to use year-specific discount rate “fundamentally” inconsistent with the Aggregate Entry Age Normal (AEAN) cost method required by SFFAS 5. The current FASAB pension and ORB standards for selecting cost attribution methods (paragraphs 63 and 82, SFFAS 5, respectively) direct the preparer to use AEAN (or other actuarial cost methods if the results are not materially different). The AEAN method is one of several cost attribution methods available. The private sector pension standard, SFAS 87, used another approach called "projected unit credit" (PUC). The primary reason given in SFFAS 5 for directing the use of AEAN was that the major federal pension plans at OPM and DoD were using it, and the Board was advised by actuaries that the results would not be substantially different than the unit benefit approach required by SFAS 87 (see SFFAS 5, par. 153).

A54. In addition, the respondent did not believe that allowing a single rate if the "result" is not materially different, as was done in the ED paragraph 27, would sufficiently address the cost attribution method issue. This respondent did not believe that year-specific discount rates should be required, even if the Board wants to allow them.

A55. This respondent also commented that the perspective of the government's borrowing cost with the public is not necessarily relevant from the point of view of the employer entity in the case of a funded plan. Although this respondent's plan is a federal plan holding federal securities, from this respondent's perspective, the plan is funded. Therefore, this respondent believes the investment yield perspective for the discount rate has relevance. From the employers' perspective, this respondent did not believe the statement in paragraph A25 of the exposure draft about the equivalence of two plans with the same benefit provisions (one funded and one not), is necessarily correct.

A56. This respondent stated that, from the overall federal government perspective, it is not clear what constitutes the best basis for the discount rate assumption. This respondent believes the statement in paragraph A24 of the exposure draft that the rationale for using marketable Treasury securities for the discount rate is that they reflect the government's borrowing cost with the public is questionable. This respondent asserted that a private company would not value a given future obligation at its own borrowing cost.

A57. This respondent acknowledged that, in the sense that Treasury securities represent risk-free investments (as described in paragraph A27, of the exposure draft) arguments can be made for their use as the discount rate basis. However, this respondent asserted that two circumstances make an investment yield approach preferable. First, when the entity employs an independent actuarial board, the respondent believes that board's assumptions for the financial statement valuations make the most sense, especially when Congress has created the independent expert for setting the assumptions. Second, an investment yield approach is preferable when the funding in a trust fund is comprised entirely of investments that mirror marketable US Treasury securities. This respondent states that arguments that the discount rate should not be impacted by the particular portfolio of securities in a trust fund at a given time are not valid in the context of an alternative involving "a vague, undefined 'historical' average."

A58. Another respondent commented that the phrase “average historical Treasury rates” is unclear but consistent with ED paragraph 28 with respect to the need for the reporting entity to use judgment, and with the notion of Congressionally-established expert Boards for trust funds restricted to investing in securities that mirror marketable US Treasury securities.

A59. Other respondents prefer more guidance regarding the time-period for and meaning of average historical rates. Several respondents recommended limiting the time-period to 5 years, if average historical rates are used, feeling it would better reflect the current market than longer horizon and that that would be a sufficiently long period.

A60. One respondent asked for more explanation and guidance with respect to the phrase “extrapolated from historical Treasury borrowing rates.” It is possible for projected cash flows to extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security. The proposed standard required the preparer to incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates, that is, use the historical rates as indicative of what future rates will be.

The Board’s Conclusions regarding Discount Rates

A61. The Board decided to retain the average historical Treasury rate approach proposed in the exposure draft. Thus, the entity should employ Treasury borrowing rates associated with each future year involving relevant cash flow. This is sometimes called the “yield curve” approach.

A62. With respect to the attribution methods, the Board does not believe the standard is inconsistent with the Aggregate Entry Age Normal (AEAN) attribution method required in SFFAS 5. The change in the discount rate applied to a particular future cash flow would be a function of (1) the passage of time and (2) the market rate for each maturity, as evidenced by historical rates. It would not represent a change in assumption per se. In other words, the discount rate does not necessarily change, the period changes. There would be a one-year rate, a two-year rate, a 5-year rate, etc., that would not (necessarily) change each year. The average historical rate would change only when the data dictated. The mere fact that a payment that was due in 5 years is now due in 4 years would not constitute an assumption change. The Board does not believe that the requirement is conceptually inconsistent with the AEAN or other provisions of SFFAS 5, paragraphs 63 and 82.

A63. Regarding whether to use the entity’s investment return for determining a discount rate, the Board continues to believe that discount rates for present value measurements of federal pension, ORB, and OPEB liabilities should be average historical rates for marketable Treasury securities because it reflects the government’s borrowing cost with the public and therefore the time value of money for the government. The Board also believes that there should be consistency among federal entities. The discount rate is used to calculate the present value of the obligation and annual cost increments and should be the same, everything else being equal, between funded and unfunded pension, ORB, and OPEB programs. Moreover, overly optimistic assumptions about investment returns have provided inaccurate financial information about public and private sector pensions.

A64. The Board believes that the average historical Treasury rate standard is clear and well defined. The objective is a principle-based requirement where the reporting entity would use its judgment when developing the rate.

A65. The Board considered the request for more guidance regarding the number of instances to include in an average historical rate. The Board decided to establish a minimum number of five historical Treasury rates to include for the average. The exposure draft did not specify a minimum or maximum number of historical Treasury rates for developing an average. The Board believes that setting a minimum number of historical rates to include in the average would ensure that the discount rate captures richer experience and avoids undue focus on the current market rate. In addition, a standard requiring a minimum of five periodic rates for the average would not encourage the use of so many historical rates as to render the average rate antiquated.

A66. The Board was concerned regarding the possibility that the entity would frequently change the number of Treasury rates included in the average rate. The Board's believes that the reporting entity should be consistent from period to period with respect to the number of rates included in the average. SFFAC 1, *Objectives of Federal Financial Reporting*, and SFFAC 2, *Entity and Display*, states that consistency is one of the qualitative characteristic of accounting information.[15] The Board concluded that the standard should require the entity's accounting policy disclosure to include the policy of consistency in this regard, which is the intent of paragraph 31.

A67. The Board notes that a respondent criticized as vague the exception provided in the exposure draft allowing entities to use a single rate for discounting if the resulting present value is "not materially different" than the resulting present value using the approach in the standard. The respondent commented that the single rate would need to be compared to the various components of expense to not materially differ. Nonetheless, the Board believes that this exception may be useful to preparers. If the result of applying a single composite discount rate to the cash flows vs. individual rates is not materially different, then the preparer may use the single rate. This exception is a continuation of one currently in FASAB pension and ORB standards and has been in effect since October 1996. However, the standard now specifies that the resulting present value of the entity's single rate should not be materially different than the resulting present value using the approach in the standard.

[15] See SFFAC 1, par. 163, and SFFAC 2, par. 109.

A68. With respect to a respondent's comment about the use of expert actuarial boards, the Board notes that such boards provide assumptions for funding and other purposes and presumably also would provide assumptions for general-purpose financial statements. However, for the latter, under the standard, they would look at the broader historical market for Treasury securities for context. Actuaries work with requirements appropriate to specific objectives. The Board concludes that the general requirement for average historical rates should be retained.

A69. With respect to the request for additional guidance regarding the phrase "extrapolate from historical Treasury borrowing rates" where projected cash flows extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year maturity, the Board notes that there are several methods that can be applied to extend a yield curve for terms beyond the last available rate in the market. The International Actuarial Association's Risk Margin Working Group's (RMWG) recent exposure draft[16] on measuring liabilities for insurance contracts mentions that the simplest approach is to use the last available rate (for example the 20-year rate for a 30-year cash flow), and that a more advanced method would be to extrapolate the yield curve with a constant slope assuming that the forward rate observed between the last two market rates stays constant. In addition, the RMWG ED states that a model can be applied to extend the yield curve and cites several examples. The Board believes these approaches are reasonable.[17]

Selecting Valuation Date

What the Exposure Draft Proposed regarding Valuation Dates

A70. The FASAB has addressed the issue of valuation dates for present valuations in various ways. The sections of SFFAS 5 dealing with pensions, ORB, and OPEB do not mention valuation dates, but the Board did address it in Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997). In Interpretation 3 the Board decided that pension and retirement health care liabilities should be measured for general purpose federal financial reports as of the end of the reporting period, and that such measurement should be based on an actuarial valuation within a year of the end of the reporting period.

A71. In Interpretation 3 the Board had been asked to endorse use of an actuarial valuation date as of the beginning of the fiscal year, which had been the practice in some of special

[16]Risk Margin Working Group, *Measurement of Liabilities for Insurance Contracts: Current Estimate and Risk Margins*, March 24, 2008 ("RMWG ED").

[17] RMWG ED, page 31.

purpose financial reports on pension plans prepared pursuant to statutory provisions. Some actuaries were concerned that differences between actuarial measurements used in different reports would cause problems and confusion. Some people who supported 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. However, other people believed that liability measurements 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.

A72. SFFAS 17, *Accounting for Social Insurance*, does address the valuation date, specifying that it should be as of any time within a year of the reporting date.

A73. Although it does not explicitly discuss the valuation date, SFFAS 5 implicitly calls for measurement at the reporting date for pension, ORB, and OPEB liabilities, which are reported as of the balance sheet date.

A74. FASB's Statements 87 and 106 allowed preparers to use a valuation date for measuring pension and other postretirement liabilities up to three months earlier than the reporting date. However, FAS 158 published under Phase I of FASB's pension project requires the measurement of plan assets and benefit obligations to be as of the date of the sponsoring employer's statement of financial position. The FASB concluded that this will more accurately reflect the economic status of defined benefit plans and further improve the understandability of the financial statements.[18]

A75. In Statement 27 and Statement 45, the GASB did not require the valuation date to be the employer's balance sheet date. Statement 27 requires the expense/expenditure amount to be based on the results of an actuarial valuation performed in accordance with the parameters as of a date not more than 24 months before the beginning of the employer's fiscal year. Statement 45 requires that the actuarial valuation date generally should be the same date each year (or other applicable interval). However, in both instances a new valuation would be required if, since the previous valuation, significant changes occurred that affect the results of the valuation, including significant changes in benefit provisions, the size or composition of the population covered by the plan, or other factors that impact long-term assumptions.

A76. The Board believes that the approach in Interpretation 3 is preferable. Pension, ORB, and OPEB liabilities should be measured as of the end of the reporting period based on a full

[18] FAS 158, par. B16.

actuarial valuation within a year of the end of the reporting period. Thus, "full actuarial valuations," as that term is used by actuaries, can be performed as of an earlier date during the fiscal year than year end, including a beginning-of-year date, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise and cost of living adjustment. Such adjustments are sometimes referred to as a measurement based on a "projection" or "roll-forward."

Respondents Comments regarding the Valuation Date

A77. Most of the respondents who commented on the proposed valuation date standard commented that it was appropriate. One respondent asserted that its valuation dates are based on statutory requirements.

The Board's Conclusions regarding Valuation Date

A78. The Board continues to believe that pension, ORB, and OPEB liabilities should be measured as of the end of the reporting period based on a full actuarial valuation within a year of the end of the reporting period.

Reasonable Estimates

What the Exposure Draft Proposed regarding Reasonable Estimates

A79. The proposed Statement also addressed an issue with respect to the meaning of "best estimate." The proposed Statement provided that estimates should be reasonable under the circumstances (see paragraph 31). The notion of "best estimate" has been used in several FASAB standards, for example, in SFFAS 5, paragraph 65, SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, paragraph 67.1, and in various instances in SFFAS 17. However, preparers and auditors have reported disagreements regarding the meaning of the word "best," which is sometimes defined as "excelling all others." Thus, the Board proposed to replace the term "best estimate" in FASAB standards with "reasonable estimate."

A80. Actuarial Standards of Practice (ASOP) provide guidance regarding the meaning of "best estimate" in ASOP 10, *Methods and Assumptions for Use in Life Insurance Financial Statements Prepared in Accordance with GAAP*, and ASOP 27, *Selection of Economic Assumptions for Measuring Pension Obligations.* ASOP 27 instructs actuaries to select a specific economic assumption from within his or her "best estimate range" with respect to that assumption, which it defines as "the narrowest range within which the actuary reasonably anticipates that the actual results … are more likely than not to fall"[19] [emphasis added]. ASOP 27 provides, generally, that

[19] ASOP 27, Section 2.1.

"[b]ecause no one knows what the future holds with respect to economic and other contingencies, the best an actuary can do is to use professional judgment to estimate possible future economic outcomes based on past experience and future expectations, and to select assumptions based upon that application of professional judgment. Therefore, an actuary's best-estimate assumption is generally represented by a *range* rather than one specific assumption. The actuary should determine the best-estimate range for each economic assumption, and select a specific point from within that range. In some instances, the actuary may present alternative results by selecting different points within the best-estimate range" [emphasis added].[20]

A81. The Board concluded that ASOP 10 and 27 apply a standard of reasonableness regarding "best estimate," and that that is an appropriate approach. Therefore, paragraph 31 of the exposure draft called for the preparer's estimate to reflect what is reasonable to assume under the circumstances, rather that the preparer's "best estimate."

Respondents Comments regarding Reasonable Estimates

A82. One respondent objected to the proposed requirement that the preparer compare assumptions used for the liability estimate with assumptions generally used in the federal government as evidenced by independent sources, unless their actuarial board is considered an "independent source." Another respondent was concerned that the proposed standard may prove inconsistent with the historical rates used in setting discount rates, because it permits the use of the entity's own assumptions as long as they can be justified if they deviate from independent sources. They suggest this possible inconsistency be discussed in the guidance. Another respondent commented that the requirement is not clear regarding whether it applies to pension and actuarial valuations or other estimated liabilities that employ long-term assumptions such as environmental liabilities and, if so, as to what independent source should be used.

The Board's Conclusions regarding Reasonable Estimates

A83. Paragraph 35 of the standard requires the preparer to compare its assumptions with assumptions used generally in the federal government as evidenced by sources independent of the reporting entity and, if its assumptions do not reflect such data, explain why it is inappropriate to do so. A respondent suggested that the Board consider specifying a set of federal assumptions for this purpose. Some assumptions will involve general economic parameters while others will be particular to the entity.

[20] ASOP 27, Section 3.1.

A84. The Board's objective in this regard is for the entity to inform the reader about the reasonableness of the assumptions used in the preparation of its financial reports. With respect to sources for assumptions generally in use in the federal government, the standard offers the example of Bureau of Economic Analysis' assumptions but does not require the use of these or other particular sets of federal assumptions. The Board decided not to change the standard in this regard. The Board believes a comparison with a benchmark is likely to be meaningful to users. The preparer should use its judgment to select assumptions used generally in the federal government that are relevant to its activities and estimates. In addition, the narrowing of the scope of the standard to pensions, ORB, and OPEB will narrow the comparison as well.

Board Approval

A85. This Statement was approved for issuance by all members of the Board.

Appendix B: Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions

Component Entity: Pro forma *Statement of Net Cost for the Year Ended September 30, 2007*

	2007 (billions)
ABC Program	
ABC expenses	$ 223
Less: exchange revenue	24
Net expense before gain/loss from changes in assumptions	199
(Gain)/loss on assumption changes:	
Discount rate assumption	200
Other assumptions	(50)
Net (gain)/loss on assumption changes	150
Net cost	$349

Governmentwide Entity: Pro Forma *Statements of Net Cost for the Year Ended September 30, 2007*

	Gross Cost	Earned Revenue (billions)	Net Cost
ABC Agency……….……………………….	$ 199	$ 24	$ 223
OPM…………………………………………….	***	**	***
DVA……………………………………………..	***	**	***
XYZ……………………………………………..	***	**	***
* * *			
Other agencies………………………………..	146	92	54
Cost ***before gains/losses from changes in assumptions:***	3,060	226	2,834
Less: ***loss (plus gain) from changes in assumptions***:			
ABC…………………………………………	150	0	150
OPM………………………………………..	100	0	100
DVA………………………………………..	110	0	110
Total cost …………………………………….	$3,420	226	$ 3,194

Appendix C: Pro Forma Note Disclosure of OPEB Liabilities and Expense

Post Employment Actuarial Liabilities (in billions)

	Civilian	Military	Veterans	Balance Sheet Total
Beginning balance	1,496.3	1,563.0	924.8	4,062.1
Expense				
Normal cost	41.5	33.4	XXX	
Interest on the liability balance	92.4	96.9	XXX	
Assumption changes	0.2	58.5	XXX	
Plan amendments (prior service cost)	-	25.8	XXX	
Actuarial (gain)/loss	1.9	4.6	XXX	
Other	(0.2)		XXX	
Total expense	135.8	219.2	XXX	
Less benefits paid	(67.6)	(52.9)	XXX	
Subtotal of pension and health	1,564.5	1,729.3	XXX	
Ending balance, other benefits	48.5	26.9	-	
Total post employment actuarial liabilities	1,613.0	1,756.2	1,122.6	4,491.8

Appendix D: Note 11 from FY 2006 Financial Report of the United States

Note 11. Federal Employee and Veteran Benefits Payable

The Government offers its employees life and health insurance, as well as retirement and other benefits. These benefits, which include actuarial and amounts due and payable to beneficiaries and health care carriers, apply to civilian and military employees.

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2006, and 2005, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian		Military		Total	
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Pension and accrued benefits	1,349.0	1,273.8	967.1	895.4	2,316.1	2,169.2
Post-retirement health and accrued benefits	295.2	290.7	837.2	833.9	1,132.4	1,124.6
Veterans compensation and burial benefits	N/A	N/A	1,153.8	1,122.6	1,153.8	1,122.6
Life insurance and accrued benefits	34.2	32.9	-	-	34.2	32.9
FECA benefits	14.4	14.3	22.2	22.7	36.6	37.0
Liability for other benefits	1.5	1.3	4.4	4.2	5.9	5.5
Total Federal employee and veteran benefits payable	1,694.3	1,613.0	2,984.7	2,878.8	4,679.0	4,491.8

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued pension liability as of September 30, 2005	1,273.8	895.4	2,169.2
Pension Expense:			
Normal costs	26.8	15.6	42.4
Plan amendment changes	-	0.1	0.1
Assumption changes	1.0	35.4	36.4
Interest on liability	78.0	55.0	133.0
Prior (and past) service cost	-	-	-
Actuarial (gains)/losses	29.7	6.1	35.8
Total pension expense	135.5	112.2	247.7
Less benefits paid	60.3	40.5	100.8
Actuarial accrued pension liability as of September 30, 2006	1,349.0	967.1	2,316.1

Significant Long-Term Economic Assumptions Used in Determining Pension Liability and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.00%	6.25%
Rate of inflation	3.50%	3.25%	3.00%	3.00%
Projected salary increases	4.25%	4.00%	3.75%	3.75%

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2005	290.7	833.9	1,124.6
Post-Retirement Health Benefits Expense:			
Normal costs	11.2	21.0	32.2
Interest on liability	17.1	52.9	70.0
Other actuarial (gains)/losses	(12.5)	(53.8)	(66.3)
Total post-retirement health benefits expense	15.8	20.1	35.9
Less claims paid	11.3	16.8	28.1
Actuarial accrued post-retirement health benefits liability, as of September 30, 2006	295.2	837.2	1,132.4

Significant Long-Term Economic Assumptions Used in Determining Post-Retirement Health Benefits and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.25%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. Both boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The board for DOD uses a range of rates for the inflation and the projected salary increases, with an ultimate rate for the long term. The board for DOD also uses different health care cost inflation rates for inpatient, outpatient, and prescription drugs. The long-term ultimate rate is shown in the tables above.

The long-term ultimate rate for fiscal year 2006 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2006 is 7.20 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

Appendix E: Glossary

(See the Consolidated Glossary - Appendix E in this volume.)

Appendix F: List of Abbreviations

ANPV	Actuarial net present value
CFS	Consolidated financial statements
CPI	Consumer Price Index
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
OMB	Office of Management and Budget
OPEB	Other postemployment benefits
ORB	Other retirement benefits
PV	Preliminary Views
RSI	Required supplementary information
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standard

Statement of Federal Financial Accounting Standards 34: The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board

Status

Issued	July 28, 2009
Effective Date	Upon issuance.
Affects	None.
Affected by	None.

Summary

The Federal Accounting Standards Advisory Board (FASAB) is the body designated by the American Institute of Certified Public Accountants (AICPA) as the source of generally accepted accounting principles (GAAP) for federal reporting entities.[1] As such, the FASAB is responsible for identifying the **GAAP hierarchy** for federal reporting entities. The GAAP hierarchy consists of the sources of accounting principles and the framework for selecting the principles used in the preparation of general purpose financial reports[2] of federal reporting entities that are presented in conformity with generally accepted accounting principles. However, the hierarchy for selecting the principles used in the preparation of general purpose financial reports by federal reporting entities was set forth in the AICPA Statement on Auditing Standards (SAS) No. 91, *Federal GAAP Hierarchy*, rather than in the authoritative literature of the FASAB. This Statement incorporates the hierarchy into the FASAB's authoritative literature.

Incorporating the GAAP hierarchy into the authoritative literature of the FASAB is not intended to cause a sudden and dramatic change in practice for federal entities. This Statement permits those federal entities currently applying financial accounting and reporting standards issued by the Financial Accounting Standards Board (FASB) to continue to do so. In addition, given that the FASAB is the source of GAAP for federal entities, the Statement clarifies that a federal entity that is preparing GAAP-based general purpose financial reports for the first time is required to implement FASAB standards unless, in consultation with its auditors and bodies with oversight authority, the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards.

[1] Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, discusses the criteria for defining federal reporting entities. Also, the terms federal reporting entity and federal entity are used interchangeably throughout this Statement.

[2] The term general purpose financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report is known as the Performance and Accountability Report or the Agency Financial Report.

Table of Contents

Introduction

Purpose

1. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of general purpose financial reports of federal reporting entities[3] that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy).

    a. This Statement responds to a request from the American Institute of Certified Public Accountants (AICPA) that FASAB incorporate the GAAP hierarchy, which currently resides in the professional auditing literature, into the accounting literature.

    b. This Statement also addresses (1) whether federal entities currently applying standards issued by the Financial Accounting Standards Board (FASB) may continue that practice, and (2) whether federal entities that are preparing GAAP-based general purpose financial reports for the first time may also apply FASB standards.

Materiality

2. 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

3. The requirements in this standard are effective upon its issuance.

[3]Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, provides criteria for identifying federal reporting entities. In addition, the Board is currently developing standards defining the federal reporting entity.

Accounting Standards

Scope

4. This Statement applies to the general purpose financial reports of all federal reporting entities that are presented in conformity with generally accepted accounting principles (GAAP).[4]

The Hierarchy of Generally Accepted Accounting Principles

5. The hierarchy of generally accepted accounting principles, hereafter referred to as the GAAP hierarchy, governs what constitutes GAAP for federal reporting entities. It lists the priority sequence of pronouncements that a federal reporting entity should look to for accounting and financial reporting authoritative guidance. The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows:

    a. Officially established accounting principles consist of FASAB Statements of Federal Financial Accounting Standards (Standards) and Interpretations. FASAB Standards and Interpretations will be periodically incorporated in a publication by the FASAB.

    b. FASAB Technical Bulletins and, if specifically made applicable to federal reporting entities by the AICPA and cleared[5] by the FASAB, AICPA Industry Audit and Accounting Guides.[6]

    c. Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

    d. Implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

[4]The AICPA has designated the FASAB as the source of GAAP for federal reporting entities. Therefore, FASAB GAAP would be the appropriate accounting standards for federal reporting entities in the executive, legislative, and judicial branches.

[5] For purposes of interpreting category (b), the word *cleared* means that the FASAB does not object to the pronouncement's issuance.

[6]Such pronouncements specifically made applicable to federal reporting entities are presumed to have been cleared by the FASAB, unless the pronouncement indicates otherwise.

6. If the accounting treatment for a transaction or event is not specified by a pronouncement in category (a), a federal reporting entity should consider whether the accounting treatment is specified by an accounting principle from a source in another category. In such cases, if categories (b)–(d) contain accounting principles that specify accounting treatments for a transaction or event, the federal reporting entity should follow the accounting treatment specified by the accounting principle from the source in the highest category—for example, follow category (b) treatment over category (c) treatment.

7. If the accounting treatment for a transaction or event is not specified by a pronouncement or established in practice as described in categories (a)–(d), a federal reporting entity should then consider accounting principles for similar transactions or events within categories (a)–(d) before considering Other Accounting Literature discussed in paragraph 8. For example, it might be appropriate to report the event or transaction by applying, in a similar manner, an accounting principle established within categories (a)-(d) for an analogous transaction or event on the basis of its substance.[7] A federal reporting entity should not follow the accounting treatment specified in accounting principles for similar transactions or events in cases in which those accounting principles either (a) specifically prohibit the application of the accounting treatment to the particular transaction or event or (b) indicate that the accounting treatment should not be applied to other transactions or events by analogy.

Other Accounting Literature

8. Other Accounting Literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in category (b) of paragraph 5 when not specifically made applicable to federal reporting entities by the FASAB; pronouncements of other accounting and financial reporting standards-setting bodies, such as the FASB, Governmental Accounting Standards Board, International Accounting Standards Board, and International Public Sector Accounting Standards Board; professional associations or regulatory agencies; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category.

[7] Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. Consideration should be given to whether the substance of transactions or events differs materially from their form.

Application of Standards Issued by the Financial Accounting Standards Board

9. Some federal entities, including government corporations listed in the Government Corporation Control Act and certain others, such as the United States Postal Service, continue to publish financial reports pursuant to the accounting and reporting standards issued by the FASB. Some entities also may be required to prepare statements pursuant to standards set by a regulatory agency (e.g., the Federal Energy Regulatory Commission (FERC)). General purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.[8]

10. Except as provided in paragraph 11, a federal entity that is preparing GAAP-based general purpose financial reports for the first time should implement FASAB standards as FASAB is the preferred method of reporting for federal entities.

11. In rare instances, a federal entity that is preparing GAAP-based general purpose financial reports for the first time may, in consultation with its auditors and bodies with oversight authority, elect to apply standards issued by the FASB if the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards. Unique user needs can arise from various sources that include, but are not limited to, investors, SEC requirements, bondholders, and customers. Entities may determine that the application of standards issued by the FASB more appropriately meets these unique user needs. This determination should involve a number of considerations. Examples of factors to consider include but are not limited to:

    a. The entity's primary funding is derived from a source other than through annual federal appropriations.

    b. The entity has been delegated the financial and operational authority to carry on its activities in a manner similar to private business enterprises.

    c. The entity sells goods and/or services to individuals outside of the government reporting entity as its principal activity.

[8] The FASAB has an existing project underway that will assist the Board in determining whether certain federal entities should be permitted to continue applying FASB GAAP and, if so, whether additional reporting should be required. This project will also consider whether federal entities should be permitted to convert from FASB standards to International Financial Reporting Standards published by the International Accounting Standards Board.

d. The entity is intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the federal government reporting entity.

e. It is desirable to compare general purpose financial reports of the federal entity that is preparing GAAP-based general purpose financial reports for the first time with an existing entity that is already following FASB GAAP.

12. While the application of standards issued by the FASB may be acceptable for a limited number of federal entities as noted above, entities that have already implemented standards issued by the FASAB should continue to apply the federal standards, as FASAB is the preferred method of reporting for federal entities.

Effective Date

13. The requirements in this standard are effective upon its issuance.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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 and reporting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. Representatives of the American Institute of Certified Public Accountants (AICPA) requested that the U.S. accounting standards-setters consider adopting certain guidance for accounting and financial reporting issues that now reside in the professional auditing literature. In July 2008, the FASAB joined the Governmental Accounting Standards Board in responding to this request.

A2. In October 1999, The AICPA designated the FASAB as the standards-setting body for federal entities. As such, the FASAB is responsible for identifying the sources of accounting principles and providing federal entities with a framework for selecting the principles used in the preparation of general purpose financial reports that are presented in conformity with GAAP (GAAP hierarchy). The Board believes that incorporation of the GAAP hierarchy into the FASAB's authoritative literature would more clearly convey that financial statement preparers are responsible for selecting the sources of the principles to be used in the preparation of general purpose financial reports that are presented in conformity with GAAP. The structure presented in this Statement generally carries forward the hierarchy as set forth in SAS 91 and the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements.

Application of Standards Issued by the Financial Accounting Standards Board

A3. Although the FASAB's standards have been recognized as GAAP for federal entities (FASAB GAAP) since October 1999, some federal entities follow GAAP for nongovernmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP). For example, federal government corporations, the U.S. Postal Service, certain component entities of the U.S. Department of the Treasury, and some smaller entities in the executive and legislative branches have historically applied FASB GAAP and continue to do so.

A4. In early 2000, the FASAB recognized this practice as acceptable for those entities that had been following FASB GAAP to avoid an immediate and unanticipated requirement that these federal entities follow federal GAAP after the FASAB was recognized as the Rule 203 standards-setting body for the federal government. This guidance was published in the January – March 2000 issue of *FASAB News*[9] and was intended as a temporary measure in light of the unanticipated consequences of Rule 203 recognition. The existence of the issue has also been acknowledged in Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display* (paragraph 78); Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* (inside front cover and Appendix A, paragraph 142); SFFAS 8, *Supplementary Stewardship Reporting* (Introduction paragraph 40); and, SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government* (Appendix A, paragraph 20).

A5. Providing interim guidance on the application of standards issued by the FASB serves to proactively address entity concerns that moving the hierarchy of generally accepted accounting principles into the accounting literature without addressing the use of FASB GAAP would require a sudden and dramatic change in practice.

Application to Legislative and Judicial Branches

A6. The FASAB's sponsors do not prescribe accounting standards for the legislative and judicial branches. The legislative and judicial branches, and most entities within those branches, are not currently required to prepare general purpose financial reports and those that do prepare statements are not subject to any requirements by the FASAB's sponsors to follow FASAB GAAP or prepare a reconciliation between FASAB GAAP and FASB GAAP. However, as the source of GAAP for federal reporting entities, FASAB GAAP would be the

[9] FASAB News, Jan.-March 2000, p. 2.

appropriate accounting standards for these entities to adopt if they prepare GAAP-based general purpose financial reports.

Exposure Draft

A7. The Board published the exposure draft (ED), *The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board*, on December 2, 2008, with comments requested by February 3, 2009. Upon release of the ED, notices and press releases were provided to: The Federal Register, *FASAB News, The Journal of Accountancy, AGA Today*, the *CPA Journal, Government Executive*, the *CPA Letter*, and *Government Accounting and Auditing Update*, The CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council, and committees of professional associations generally commenting on EDs in the past.

A8. This broad announcement was followed by direct mailings of the ED to the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate; and the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives.

A9. The Board received 31 response letters from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		3
Auditors	5	1
Preparers and financial managers	22	
Totals	27	4

A10. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. Respondents generally agreed that the hierarchy of GAAP that currently resides in the professional auditing literature should be incorporated into the FASAB's authoritative literature. Also, respondents generally agreed that: 1) general purpose financial reports prepared in conformity with accounting standards issued by the FASB should be regarded as being in conformity with GAAP for those federal entities that have in the past issued such reports, and 2) a federal reporting entity that is preparing GAAP-based general purpose financial reports for the first time should implement FASAB standards unless the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards.

A12. However, some respondents believed it would be useful to clarify certain aspects of the Statement. Some respondents believed it would be useful to clarify where administrative directives (e.g. OMB, Government Accountability Office, and Department of the Treasury guidance) would be considered in the hierarchy. Some respondents questioned if "Other Accounting Literature" was a part of or separate from the hierarchy.

A13. In addition, some respondents believed that those federal entities following FASB standards could be required to reconsider their practices. For example, if they receive federal appropriations, they should follow FASAB standards.

Clarifying the GAAP Hierarchy and Other Accounting Literature

A14. Paragraph 5 of the Statement presents the GAAP hierarchy for federal entities, and the Board expects practice to be governed by this hierarchy. The hierarchy presented in the ED referred to AICPA Statements of Position (SOP) and Practice Bulletins specifically made applicable to federal reporting entities and cleared by the FASAB. However, the FASB is codifying its accounting standards and SOPs and Practice Bulletins will generally be incorporated into the codification and have no continued authority. Because of this matter and because no SOPs and Practice Bulletins have been specifically made applicable to federal reporting entities and cleared by the FASAB, these sources were removed from the hierarchy.

A15. In addition, while some respondents believed that it would be useful to discuss the location of administrative directives within the hierarchy, the FASAB believes that incorporating the GAAP hierarchy in the accounting standards should be accomplished expeditiously due to the AICPA's planned removal of the hierarchy from the auditing standards. Since FASAB is unaware of any practice problems arising due to the absence of explicit guidance placing each type of administrative directive within the hierarchy, immediate action on this request is not warranted.[10] FASAB also notes that there are multiple sources of administrative directives, many types of directives, and varying processes for developing directives. Resolving placement for all administrative directives may require significant study.

[10] This request will be considered when the Board reviews its technical agenda to select new projects.

Therefore, the Board is acting to adopt the GAAP hierarchy essentially as it currently exists in the AICPA audit literature and does not intend to change current practices.

A16. Paragraphs 6 and 7 of the Statement provide guidance to assist readers in understanding how the hierarchy should be considered when preparing general purpose financial reports in conformity with GAAP.

A17. Paragraph 7 also discusses when to consider literature not discussed in the GAAP hierarchy - Other Accounting Literature. The phrase “Other Accounting Literature” is capitalized in the Statement and included under a separate heading to indicate its distinction from the GAAP literature. Other Accounting Literature is presented separately from the hierarchy because the items in this category do not establish GAAP and cannot amend existing FASAB standards, interpretations, technical bulletins or releases, or staff implementation guidance. Other Accounting Literature may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of literature in paragraph 5 of the Statement.

A18. The Board also recognizes that other standards-setting bodies are currently considering codifying their pronouncements. As a result, listing the titles of specific pronouncements in Other Accounting Literature may cause difficulty in referencing those documents in the future. Thus, paragraph 8 of the Statement refers to pronouncements of other standards-setting bodies rather than listing specific pronouncements.

Entities Following FASB GAAP

A19. As noted above, the Board primarily intended to incorporate the GAAP hierarchy into the FASAB’s accounting literature and did not intend to change existing practices at this time. The Board is continuing a separate project on reporting by federal entities that primarily apply standards issued by the FASB. The project intends to determine whether certain federal entities should be permitted to continue following FASB GAAP and what additional reporting, if any, is needed for stand-alone financial reports of federal entities that are permitted to continue applying FASB accounting standards.

A20. Paragraph 9 of the Statement states that those federal entities preparing general purpose financial reports in conformity with FASB accounting and reporting standards are permitted to continue current practices. The Statement does not preclude those entities from reconsidering those practices.

Board Approval

A21. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IASB	International Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
OMB	Office of Management and Budget
SAS	Statement on Auditing Standards
SFFAC	Statement of Federal Financial Accounting Concepts

Statement of Federal Financial Accounting Standards 35: Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23 (Rescinded)

Status

Issued	October 14, 2009
Effective Date	Upon issuance
Affects	• SFFAS 6, paragraphs 40 and 45. • SFFAS 23, paragraphs 10 – 18.
Affected by	SFFAS 50 rescinded SFFAS 35 in its entirety.
Related Guidance	TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*

Summary

SFFAS 50, *Establishing Opening Balances for General Property, Plant and Equipment* rescinded SFFAS 35 in its entirety.

Statement of Federal Financial Accounting Standards 36: Comprehensive Long-Term Projections for the U.S. Government

Status

Issued	September 28, 2009
Effective Date	The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2013.
Affects	None.
Affected by	SFFAS 45 amends paragraph 45.

Summary

This standard requires:

- A basic financial statement in the consolidated financial report of the U.S. Government (CFR) presenting for all the activities of the federal government:

  - the present value of projected receipts and non-interest spending under current policy without change,

  - the relationship of these amounts to projected Gross Domestic Product (GDP), and

  - changes in the present value of projected receipts and non-interest spending from the prior year.

- Required Supplementary Information (RSI) that explains and illustrates

    - the projected trends in:

    - the relationship between receipts and spending,

    - deficits or surpluses,

    - Treasury debt held by the public as a share of GDP,

  - possible results using alternative scenarios, and

  - the likely impact of delaying corrective action when a fiscal gap exists.

- Disclosures that explain and illustrate:
    - the assumptions underlying the projections,
    - factors influencing trends, and
    - significant changes in the projections from period to period.

These requirements will be implemented following a three-year transition period beginning in fiscal year (FY) 2010 during which all information may be presented as RSI. Beginning in FY 2013, the required information will be presented as a basic financial statement, disclosures and RSI as designated within the standards.

The required information will help readers of the CFR assess “whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.” [Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraphs 135 and 139.] Such an assessment is an important objective of federal financial reporting requiring prospective information about receipts and spending, the resulting debt, and how these amounts relate to the economy.

Table of Contents

Introduction

Purpose

1. In Statement of Federal Financial Accounting Concepts (SFFAC) 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.[1] The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

2. Objective 3, Stewardship, is the primary focus for this Statement. Objective 3 states that:

   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.[2]

3. Sub-objective 3B states that:

   Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services[3] and to meet obligations as they come due.[4]

4. While federal financial reporting is not expected by itself to accomplish the stewardship reporting objective, it can contribute to meeting the objective.[5] This Statement's contribution relates primarily to the federal government's operations and financial condition; it does not extend to an assessment of the nation's financial condition.

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[1] SFFAC 1, par. 109.

[2] SFFAC 1, par. 134.

[3] In this standard, "public services" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, transfer payments (such as Social Security benefits) or other financial benefits (such as loan guarantees), as well as national defense, transportation safety and national parks.

[4] SFFAC 1, par. 139.

[5] SFFAC 1, par. 235.

5. The Board believes that comprehensive long-term fiscal **projections**[6] make an essential contribution to meeting the stewardship objective and especially sub-objective 3B because it is concerned with the future and the resources needed in the future.

6. Long-term fiscal projections serve as the basis for key measures presented in the basic financial statement as well as narrative and illustrations required in the consolidated financial report of the U.S. Government (CFR). The more detailed objectives presented below were developed as one means of guiding the Board in developing the basic financial statement and in identifying the most important areas to be addressed through narrative, tables and/or graphics.

Objectives of Basic Financial Statement (Comprehensive Long-Term Fiscal Projections for the U.S. Government) and Accompanying Disclosures and Required Supplementary Information

7. In this Statement, "**Fiscal Sustainability Reporting**" is the short term for the basic financial statement, disclosures, and **Required Supplementary Information** (RSI) required in the CFR. Fiscal Sustainability Reporting should provide information to assist readers of the CFR in assessing whether future budgetary resources of the U.S. Government will likely be sufficient to sustain public services and to meet obligations as they come due,[7] assuming that current policy for federal government public services and taxation is continued without change (hereafter referred to as "**current policy without change**").[8]

8. Such an assessment is important not only because of its financial implications but also because it has social and political implications. For example, users of financial reports should be provided with information that is helpful in assessing the likelihood that the government will continue to provide public services to constituent groups and to assess whether financial burdens without related benefits were passed on by current-year taxpayers to future-year taxpayers.[9] Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.

[6] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[7] SFFAC 1, par. 139.

[8] Note that fiscal sustainability reporting does not extend to supporting a detailed assessment of whether current policy without change regarding federal public services and taxation is optimal; rather, it addresses the fiscal outlook if current policy is continued without change.

[9] The latter notion is sometimes referred to as "interperiod equity."

9. Fiscal Sustainability Reporting should be understandable to the intended users of the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the media, public interest and advocacy groups, and others). The CFR should be easily understandable to the "average citizen" who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence.

Materiality

10. 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

11. This Statement provides for a phased-in implementation, but earlier implementation is encouraged. All information will be reported as RSI for the first three years of implementation (fiscal years 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information will be presented as a basic financial statement, disclosures, and RSI as designated within the standard.

Accounting Standards

Scope

12. The reporting requirements in this Statement apply to the consolidated financial report of the U.S. Government (CFR). They do not apply to financial statements prepared at the component entity level. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.

Definitions

13. Fiscal Gap
The **fiscal gap** is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of **gross domestic product** (GDP).[10] More specifically, the fiscal gap is the net **present value** of projected spending[11] minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at or below the target percentage of GDP for the stated projection period. The fiscal gap may be expressed as:

    a. a summary amount in present value dollars,

    b. a share of the present value of the GDP for the projection period, and/or

    c. a share of the present value of projected receipts or projected non-interest spending.

14. Policy Assumptions
Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address

[10] GDP is the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are: private sector consumption and investment, government consumption and investment, and net exports (exports-imports).

[11] Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest ("non-interest spending").

projected spending rules for both **mandatory** and **discretionary spending**[12] as well as the framework for assessing taxes and fees.

15. Current Policy Without Change
In this standard, "current policy without change" refers to the continuation of policies in place as of the valuation date (in other words, no policy change).

16. Economic Assumptions
Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

17. Demographic Assumptions
Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

18. Public Services
In federal financial reporting, "**public services**" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, cash (such as Social Security benefits) or other financial benefits (such as loan guarantees), or services such as national defense, transportation safety, and the operation of national parks.

Policy, Economic, and Demographic Assumptions

19. Fiscal Sustainability Reporting for the U.S. Government should provide information that helps the reader to determine whether current policy without change is likely to produce future budgetary resources sufficient to sustain public services and to meet obligations as they come due. Long-term projections should help the reader to understand the fiscal implications of continuing current policy without change regarding public services and taxation along with other factors such as projected economic and demographic trends.

20. Projections of deficits, surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict result

[12]In the federal budget process, "discretionary spending" refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not "mandatory." "Mandatory spending" includes entitlement authority such as Social Security and Medicare and payment of interest on the national debt. Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation acts. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP. Available at: http://gaoweb.gao.gov (accessed May 7, 2009)

that may occur under various conditions–for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

21. Long-term projections are derived from models that rely heavily on assumptions. There is an expectation that such models will evolve over time. Therefore, this Statement provides guiding principles for selecting assumptions. The guiding principles address three types of assumptions: policy, economic, and demographic.

22. Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government.

23. Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

24. Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

25. When combined, policy, economic, and demographic assumptions determine the future projected receipts and spending.

26. To illustrate the distinction between policy, economic and demographic assumptions: consider the application of policy, economic and demographic assumptions to the Social Security program. Assumptions relating to future Social Security eligibility and benefit formulas represent policy assumptions. Assumptions about productivity growth and inflation represent economic assumptions. Assumptions about the future population represent demographic assumptions.

27. Policy assumptions should reflect reasonable assumptions about the future course of receipts and spending assuming the continuation of current policy without change. The guiding principle for selecting policy assumptions is to base selections on assumptions consistent with the continuation of policies in place as of the valuation date.

28. Current law is the best place to start when identifying “current policy without change.” However, a simple projection of “current law” would not always reflect current policy without change.

    a. Cases where a departure from current law may be appropriate include but are not limited to those in which current law

(1) expires almost immediately,

(2) contains provisions that are internally inconsistent, or

(3) has been changed in a consistent direction over time (i.e., there is a recurring history of change).

b. The following examples demonstrate how a simple projection of current law may be inconsistent with the guiding principle:

(1) Legislation providing for discretionary spending provides funding that extends at most a few years into the future. A current-law policy assumption would show discretionary spending falling to zero within a few years. In this situation a simple projection of “current law” would not reflect the implicit “current policy without change.”

(2) Current law may contain inconsistent provisions in certain situations. For example, current law may contain provisions for scheduled social insurance benefit payments as well as provisions that restrict spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare **trust fund accounts**, respectively, plus inflows of **earmarked revenues**. A current law policy assumption would not be feasible in this case since both requirements can not be met simultaneously. Thus, an interpretation of “current policy without change” will be necessary.

(3) Current law may include provisions that have been changed in a consistent direction over a period of time. For example, the statutory limit on federal debt has been consistently raised. A current-law policy assumption would be that Treasury borrowing will never increase beyond the dollar amount of the current statutory limit. In such situations a simple projection of current law would not reflect the implicit “current policy without change.”

29. Assumption of a uniform growth rate for all types of receipts and spending is not required. Assumptions may be based on, but are not limited to, the notion that non-interest spending or receipts are likely to:

a. maintain a constant share of GDP,

b. grow with inflation,[13] or

c. maintain a constant real[14] per capita level.[15]

30. Judgment should be applied in selecting assumptions. Policy assumptions representing the worst case scenario are not required. The preparer's objective should be to produce unbiased projections.

31. The same economic and demographic assumptions generally should be used for the basic financial statement for Fiscal Sustainability Reporting and for Social Security and/or Medicare in the Statement of Social Insurance (SOSI) although exceptions may be necessary when considering all projected receipts and spending. For example, an appropriate unified discount rate for all projected receipts and spending in the basic financial statement may differ from either the Social Security or Medicare discount rate. (See paragraph 40c)

32. The projection of current policy without change is intended to show the long-term results of current policy without change. The projection of current policy without change is not a forecast or prediction. This distinction must be clearly explained in the narrative accompanying the principal financial statement, the disclosures and the RSI.

Valuation Date

33. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("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.

34. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible,[16] as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes

[13] Inflation is growth in a general measure of prices, usually expressed as an annual rate of change.

[14] In economic terms, "real" means adjusted to remove the effects of inflation.

[15] As applicable, the characteristics of the population should be considered for expenditures that benefit identifiable subgroups.

[16] Factors affecting feasibility include but are not limited to the timing of the enactment of legislation and the ability of the preparers to revise the financial statements and/or the ability of the auditors to audit the revised information prior to the issuance of the financial statements and/or the audit opinion.

are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

Projection Periods

35. Projections in the basic financial statement should be for a finite projection period sufficient to illustrate long-term sustainability. If the projection period in the basic financial statement is not consistent with the projection period used for Social Security and Medicare in the SOSI, the disclosures should display the subtotal and total line items of the basic financial statement calculated for the projection period that was used for Social Security and Medicare in the SOSI.[17]

Basic Financial Statement

36. The basic financial statement, Long-Term Fiscal Projections for the U.S. Government, should state the projection period and display the following projected amounts as both present value dollars and as a percentage of the present value of GDP for the projection period indicated:

    a. receipts, disaggregated by major programs such as Medicare, Social Security, and all other receipts, and total receipts;[18]

    b. non-interest spending, disaggregated by major programs such as Medicare, Medicaid, Social Security, and all other non-interest spending, total non-interest spending; and

    c. the difference between projected receipts and projected non-interest spending.

37. After the initial year of implementation, the basic financial statement should also present comparative amounts for the current year and prior year, and the net change for each line item from the prior year as both present value dollars and as a percentage of the present value of GDP for the projection period indicated.

[17] The SOSI projection period is required to be "sufficient to illustrate long-term sustainability (for example, traditionally the "Social Security" or OASDI, program has used a projection period of 75 years for long-term projections)." See SFFAS 17, paragraph 27.

[18] Full payment of amounts due to Social Security and Medicare HI Trust Funds must be included as receipts for Medicare and Social Security, and outlays for "rest of government."

38. Fiscal gap information should be provided, either on the face of the financial statement or in the disclosures.

Disclosures

39. Disclosures should include an explanation of the following limitations:

    a. Forward-looking projections require assumptions and estimates relating to future events, conditions, and trends; actual results may differ materially from those that are projected.

    b. Forward-looking projections focus on future cash flows, and do not reflect either the accrual or modified-cash basis of accounting.

    c. Projections are <u>not</u> forecasts or predictions; they are designed to answer the question "what if?" – for example, what would be the impact on federal borrowing if current policies without change were continued for a long period of time?

    d. Forward-looking projections may also encompass hypothetical future trends or events that are not necessarily deemed probable (for example, the assumed ability to continue issuing new public debt indefinitely).

    e. Fiscal Sustainability Reporting is limited to the activity of the federal government, and does not include activities of state and local governments or the activities of the private sector.

    f. The summary measures cover a finite period and consideration should be given to trends following the end of the projection period. Disclosures should refer the readers to the RSI for a further discussion of this limitation.[19]

40. Disclosures should also include:

    a. a "plain English" explanation of present value and interest rates used to calculate present value.

    b. significant policy assumptions used in making the projections.

[19] See paragraph 42.

c. any significant differences in economic and demographic assumptions from those used for Social Security and/or Medicare in the preparation of the SOSI and a reference to the note presenting assumptions used in the SOSI.

d. an explanation of the most significant departures from current law–for example, allowing for exceeding the statutory limit on federal debt.

e. the significant reasons for the changes when year-by-year comparisons are displayed. For example, significant changes may be attributable to the following broad causes:

   (1) valuation period (for example, the beginning of the projection period is one year later);

   (2) changes in policies (legislation); and

   (3) changes in assumptions or estimates.

f. The net excess of non-interest spending over receipts disaggregated between (1) programs funded by the government's general revenues (which would currently[20] include Federal Supplementary Medical Insurance (Medicare Parts B and D), as well as other programs), and (2) major programs that are funded by payroll and self-employment taxes and that are not financed in any material respect by the government's general revenues (which would currently consist of Social Security (Old Age, Survivors and Disability Insurance (OASDI)) and Medicare Part A), accompanied by a discussion of the different funding mechanisms for the two types of programs.

Required Supplementary Information

41. RSI should explain and illustrate:

   a. trends in:

      (1) historical and projected Treasury debt held by the public as a share of GDP,

      (2) historical and projected receipts and spending, and

[20] "Currently" means as of the date of Board approval of this SFFAS in June 2009.

(3) historical and projected deficits and surpluses for a progression of years beginning at least 20 years before the current year and, at a minimum, extending to the end of the projection period used in the basic financial statement. These amounts should be presented at regular time intervals (for example, every five years or ten years).

b. the major factors that are expected to have a significant impact upon projected receipts and spending, and how such factors are expected to change over time. For example, two such factors may be (1) the rising cost of health care and (2) demographic trends. Information about how such factors have changed and are expected to change over time is necessary to assist the reader in understanding the factors that influence fiscal projections.

c. if an excess of projected non-interest spending over projected receipts is indicated by the projections, the likely impact of delaying action. For example, graphics could illustrate the progressive increase in the change that would be needed to close the fiscal gap by (1) reducing non-interest spending, or (2) increasing receipts.

d. the results of alternative scenarios that are consistent with current policy without change. Alternative scenarios are projections in which one or more significant assumptions is varied from the assumptions used in the projections presented in the basic financial statement. The choice of alternative scenarios presented should consider both those that result in larger as well as those that result in smaller net differences between the present value of projected receipts and non-interest spending. Projections for alternative scenarios may be displayed in a table format. The major causes of the differences between the results of the alternative scenarios and the basic financial statement should be explained.

42. RSI should also include an explanation of the significance of the data presented or other information that puts the data into context. Options for context may include but are not limited to:

a. comparison of the data/trend with past U.S. trends and trends in other developed nations,

b. where to find information about outside organizations that use similar data to assess the long-term implications for an entity or sovereign government, for example, the role of rating organizations and/or European Union rules for member nations, and/or

c. information that may be helpful to readers in assessing whether financial burdens without related benefits were passed on by current-year taxpayers to future-year taxpayers.

43. RSI should discuss the implications of the trends in receipts and spending for periods following the end of the projection period. This requirement may be met by providing projections for an infinite horizon or a narrative discussion.

Supporting Data (Other Accompanying Information)

44. The quantitative data supporting the basic financial statement, disclosures and RSI may be provided in or referenced as other accompanying information.[21]

Effective Date

45. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2013.

    a. These standards are effective for periods beginning after September 30, 2009.

    b. Information should be reported as RSI for the first three years of implementation (fiscal years 2010, 2011, 2012, and 2013).

    c. Beginning in fiscal year 2014, the required information should be presented as specified in paragraphs 12 - 42.

    d. Earlier implementation is encouraged.

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

[21] For example, a link to a more detailed report such as the President's Budget, a Congressional Budget Office report, or the Trustees Report (*Status of the Social Security and Medicare Program*) may be provided. Note that the Trustees Report is available at: http://www.ssa.gov/OACT/TR/ (accessed May 7, 2009).

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. This project was initiated to address the Board's Reporting Objective 3, in particular sub-objective 3b, below:

Objective 3: Stewardship
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. Federal financial reporting should provide information that helps the reader to determine whether

a. the government's financial position improved or deteriorated over the period,

b. future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and

c. government operations have contributed to the nation's current and future well-being.[22]

A2. The FASAB considered what information would most likely help readers of the consolidated financial report of the U.S. Government (CFR) assess whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due.

[22] Statement of Federal Financial Accounting Concepts (SFFAC) 1, pars. 134-145, available at http://www.fasab.gov/codifica.html (accessed May 7, 2009).

A3. Discussion of such long-term fiscal issues has been described in terms such as “fiscal sustainability.” In the exposure draft (ED), the Board’s working definition of “fiscal sustainability” was the federal government’s ability to continue, both now and in the future, current policy without change regarding public services and taxation without causing debt to rise continuously as a share of GDP.[23]

A4. Throughout this project, the Board considered expert comments from a Fiscal Sustainability Reporting Task Force (“task force”) whose participants have technical knowledge relevant to the issues and/or communication expertise relevant to the challenge of how to effectively communicate complex information on long-term fiscal issues.

A5. The task force participants included representatives from the American Enterprise Institute, the Cato Institute, the Brookings Institution, and the Urban Institute; the Chief Actuaries for Social Security and Medicare; technical experts from the Treasury Department, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), and the Congressional Budget Office (CBO); members of Congress; and academics in the areas of public policy and communication.

A6. FASAB staff also researched existing reporting on comprehensive government-wide long-term projections published in English by other countries (for example, the United Kingdom, Australia, New Zealand, and Canada) and studies by the European Commission, and conferred with staff of the International Public Sector Accounting Standards Board (IPSASB).

A7. The ED, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, was issued on September 5, 2008 with comments requested by January 5, 2009. The ED proposed standards for reporting comprehensive long-term fiscal projections for the U.S. Government via a basic financial statement and disclosures. The ED proposed that the reporting requirements would be subject to a phased implementation as Required Supplementary Information (RSI) for fiscal years 2010, 2011 and 2012, and as a basic financial statement and related disclosures beginning in fiscal year 2013. Based upon public comments and Board deliberations, the final Statement provides for all information to be reported as RSI for the first three years (FY 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information will be presented as a basic financial statement, disclosures and RSI as designated within the accounting standards (paragraphs 12 - 42).[24]

[23] Determining how much a government can depart–in magnitude and/or duration–from this general notion of fiscal sustainability is beyond the scope of the Board’s efforts.

[24] See paragraph A38 for a discussion of the effective date for basic information.

A8. Upon release of the ED, notices and press releases were provided to:

a. the Federal Register;

b. *FASAB News;*

c. the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter,* and *Government Accounting and Auditing Update;*

d. the CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council; and

e. committees of professional associations generally commenting on exposure drafts in the past.

A9. This broad announcement was followed by direct mailings of the ED to majority and minority staff directors of relevant congressional committees, over 300 think tanks and public interest groups, and past respondents on similar issues, such as the FASAB's *Preliminary Views: Accounting for Social Insurance* (issued in October 2006).

A10. There were 22 responses from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		14
Auditors	3	
Preparers and financial managers	5	

A11. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized for each major issue addressed below.

A12. In addition, a public hearing was held on February 25, 2009. The public hearing addressed two EDs: this ED and another ED, *Accounting for Social Insurance, Revised.* Seven speakers addressed this ED:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		5
Auditors	1	
Preparers and financial managers	1	

Assumptions: Limitations of “Current Law” Assumptions

A13. Projections are the central feature of Fiscal Sustainability Reporting and require that assumptions be made. The Board believes that the most useful projections will reflect current policy without change regarding federal public services and taxation.

A14. Although current law is a reasonable starting point in selecting policy assumptions, a simple projection of “current law” would not always reflect current policy without change regarding public services or taxation. The Board’s proposal includes a guiding principle for selecting policy assumptions but acknowledges the role of judgment in filling voids in current law (for example, when current law expires almost immediately) or departing from current law provisions.

A15. Major provisions of current law often do not extend far enough into the future to be used as a basis for a long-range projection. Discretionary spending is primarily based upon annual appropriation acts, and even some mandatory spending programs are subject to authorizing legislation that expires in the near future. For example, the legislation authorizing several mandatory programs (such as Food Stamps, student assistance for higher education, and agricultural price supports) expires and legislative action would be required for the programs to continue past the expiration date.

A16. Current law may contain provisions for scheduled social insurance benefit payments as well as provisions that restrict spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare trust fund accounts, respectively, plus inflows of earmarked receipts. A current law policy assumption would not be feasible in this case since both requirements can not be met simultaneously. Thus, an interpretation of “current policy without change” will be necessary.

A17. Current law also may include tax provisions that expire within several years, along with a historical trend of extending those tax provisions before they expire—but only for a short period, such as one year. In such situations, current law would indicate that the tax provisions will expire on schedule, while a projection based upon current policy without change for taxation together with reasonable expectations based on recent historical trends may indicate that the tax provisions will be extended.

Fiscal Sustainability Task Force Input Regarding Policy Assumptions

A18. A majority of the task force technical experts agreed that policy assumptions for the basic financial statement that are consistent with current policy without change[25] regarding federal public services and taxation would be useful for readers of the CFR in assessing whether

[25] “Current policy without change” as defined in this Statement is not equivalent to constant dollar amounts. Current policy without change is to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

A19. A majority of the task force technical experts believe that for mandatory spending on social insurance programs, a modified version of current law (ignoring the exhaustion of the Social Security and Medicare Hospital Insurance trust fund accounts — see paragraph A16), which might also be termed “current services,” represents the most useful assumption for projecting spending for social insurance programs. However, a minority believe that any deviation from current law requires a subjective judgment that can be biased.

A20. The technical experts also acknowledged that projections for discretionary spending are more uncertain than projections for mandatory spending, since current law often only addresses the next one or two years. However, there was some agreement among the group that projecting discretionary spending growth at the same rate as assumed GDP per capita would be an example of a reasonable option for some programs.

A21. A report issued by the GAO[26] illustrates the tension between choosing current law versus current policy without change regarding federal public services and taxes. The report’s primary display contains two different projections in a single graphic presentation: the 10-year CBO baseline, which is then projected into the future (called “baseline extended”) and a different projection (called an “alternative simulation”), which includes modifications that are described in the narrative. The “baseline extended” projection is based on assumptions that focus on current law. Those assumptions are changed in the GAO’s “alternative simulation” to reflect historical trends and recent policy preferences.

A22. The GAO’s approach of showing two different sets of numbers provides a more complete picture than selecting one or the other. However, this approach does not achieve one of the most important characteristics of effective communication. All of the communication experts and many of the technical experts on the task force strongly emphasized the importance of simplicity of presentation. The Board noted that one of the greatest challenges inherent in Fiscal Sustainability Reporting is the tension between technical rigor and simplicity of presentation.

Policy Assumptions

A23. The Board believes that the most useful reporting on fiscal sustainability would illustrate the long-term effects of current policy without change regarding public services and taxation. However, there are numerous ways of projecting current policy into the future. For example, it could be assumed that discretionary spending will continue as a constant share of GDP.

[26] *The Nation’s Long-Term Fiscal Outlook, August 2007 Update* (GAO-07-1261R).

Another alternative would be to assume constant real spending per capita (which could give a different result from assuming growth at a constant share of GDP). Yet another alternative would be to assume constant growth at the rate of inflation, which may be different than the growth of GDP.[27] (Historically, nondefense discretionary spending has grown roughly with GDP while defense discretionary spending has grown slightly faster than inflation but less than GDP, often in a nonlinear pattern.)

A24. The Board believes that the details of the assumptions for projecting current policy without change should be left to the judgment of the preparer, subject to review by the auditor. Regardless of which assumptions are used for the basic financial statement, the disclosures should include an explanation of the assumptions used and alternative scenarios, as well as the reasons for and the effect of changes in assumptions that result in significant changes from amounts reported in the prior period financial statement. Readers will have access to important explanatory material.

A25. Current law may contain inconsistent provisions in certain situations (for example, regarding the impact on benefit payments upon the exhaustion of the balances in the Medicare Hospital Insurance trust fund account). As noted previously, although current law limits spending to the amounts available in the trust fund account and current earmarked revenue, current law provides for benefits that would exceed such a limit. Thus, current law contains inconsistent provisions and does not provide an answer.

A26. When current law contains inconsistent provisions, the Board believes that in selecting assumptions, the projections should reflect current policy regarding federal government public services and taxation, and should answer the question “what if current policy without change were continued over time?” The resulting projection should be accompanied by a narrative that explains what would happen if an alternative event occurs (in the example in paragraph A25, the narrative could explain what percentage of Medicare reimbursements could not be paid if legislation does not provide for maintaining current reimbursement rates).

A27. In drafting the final Statement, the Board also improved the clarity of the requirements for policy assumptions by re-ordering the content of this section. The guiding principles for when a departure from current law may be appropriate are stated first, followed by specific examples.

[27] For example, the CBO projects that the rate of inflation will be lower than the rate of GDP growth for 2007-2017. See page xi, *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007). Available at: http://www.cbo.gov (accessed May 7, 2009).

Economic and Demographic Assumptions

A28. Economic and demographic assumptions are different in scope from policy assumptions. Economic and demographic assumptions include such factors as economic growth, inflation, birth rates, net immigration, and longevity. The elements of economic and demographic assumptions are generally influenced more by a variety of external factors than by direct legislative impact.

A29. The ED proposed that the reporting requirements for Fiscal Sustainability Reporting should not dictate specific economic and demographic assumptions, but should require that the primary displays for Fiscal Sustainability Reporting should use economic and demographic assumptions that are consistent with the economic and demographic assumptions for Social Security and Medicare in the SOSI.

A30. Although a majority of respondents concurred with the ED's proposed broad and general guidance on economic and demographic assumptions, the GAO noted that in some cases, the assumptions, particularly the economic assumptions, may need to differ. For example, an appropriate unified discount rate for all projected receipts and non-interest spending in the basic financial statement may differ from either the Social Security or Medicare discount rates. Increasing the flexibility in the requirement would allow the use of the most appropriate discount rate and permit changes to other assumptions as appropriate. The GAO noted that such differences in assumptions used in the basic financial statement and those in the SOSI for Social Security and Medicare should be appropriately disclosed.

A31. The Board decided to allow the flexibility recommended by the GAO and to require disclosure for significant differences. (See paragraphs 31 and 40c.)

Basic Financial Statement

A32. The basic financial statement will report amounts in (a) present value dollars and (b) as a percentage of the present value of GDP for the projection period. The basic financial statement will be presented as RSI for a period of three years and will then become a basic financial statement.

A33. Elements considered for inclusion as mandatory requirements for the basic financial statement were:

a. total projected non-interest spending and receipts, disaggregated by major programs such as Medicare and Social Security

b. the net total of all projected receipts and non-interest spending

c. amounts displayed as both (present value) dollars and percent of GDP

d. year-to-year (for example, side-by-side) comparison with prior year

e. net change from year-to-year as a separate column

f. alternative scenario information

A34. A majority of the members decided that (a) through (e) above should be included as minimum requirements for the basic financial statement, with the format of the elements left to the discretion of the preparer. An illustrative statement is included in Appendix B. In addition, the Board concluded that the concept of fiscal gap should be explained and reported, either on the face of the financial statement or in the disclosures. An illustrative example is shown in Appendix B on the face of the illustrative basic financial statement.

A35. The Board concluded that disaggregation of specific major programs would be left to the discretion of the preparer.

A36. A majority of respondents agreed with the general guidance proposed in the ED: that major programs should be shown separately. However, respondents' suggestions that named specific examples of major programs indicated that many respondents interpreted the illustrative financial statement in Appendix B as authoritative and inferred that social insurance programs are the federal government's only "major programs."

A37. The Board decided to edit the illustrative basic financial statement in Appendix B by adding two additional lines, "Major Program A" and "Major Program B" to clarify the fact that social insurance programs are not the only major programs of the federal government.

Effective Date for Basic Information

A38. The ED proposed that the financial statement and disclosures be designated as basic information rather than continue as RSI beginning in fiscal year 2013. For three years prior to fiscal year 2013, the information in the basic financial statement and disclosures would be presented as RSI. A majority of respondents addressing this issue, including the GAO, which will have the responsibility of auditing the basic information, agreed that the proposed implementation schedule is reasonable and appropriate. The GAO did identify several requirements that should remain RSI permanently, and the Board incorporated that recommendation into the requirements of the final Statement.

A39. Given the potential for flexibility (within and between years) of policy assumptions underlying the projections, one member believes that significant disagreements between preparer and auditor are likely when the information becomes basic in fiscal year 2013. For example, paragraph 28b(3) provides an example of a situation where departure from current law may be appropriate if historically consistent changes have been made. That member notes that it remains to be seen how historically consistent the changes must be to qualify and how departures from previously consistent patterns in policy will be addressed. In addition, based on its “but not limited to” language, paragraph 28 allows for an open-ended set of exceptions which have yet to be specified and defended. He believes, therefore, that the projection information should remain RSI until such time as preparation and audit procedures concerning exceptions to the “current law” approach to “current policy without change” can be developed and agreed upon.

A40. The majority Board member view is that the preparer and auditor will resolve such disagreements by reference to the guiding principle – current policy without change. The Board is aware that significant judgment will be required. If any irreconcilable issues arise during the three-year transition period, the Board would be called upon to (1) offer implementation guidance or (2) defer the transition from RSI to basic information.

Summary Measures

A41. The Fiscal Sustainability Task Force technical experts did not agree on the usefulness of summary measures such as the present value amounts intended to be presented on the basic financial statement. Although some of the technical experts believe that summary measures convey important information, others believe that due to the inherent weakness of summary measures, they should be de-emphasized.

A42. The inherent weaknesses of summary measures that were identified by the Fiscal Sustainability Task Force and considered by the Board include but are not limited to the following:

a. A specific time horizon must be used in order to calculate any summary measure. There are no potential time horizons that do not have inherent weaknesses. Those weaknesses are discussed in paragraphs A50 - A57 below.

b. Summary measures for long-term fiscal projections for the U.S. government are likely to produce very large numbers that readers find difficult to relate to. One potential remedy for this would be to report the numbers on a per capita basis, but that approach has weaknesses. Those weaknesses are discussed in paragraphs A46 - A49 below.

c. Potential “bottom-line” summary measures include fiscal imbalance and fiscal gap, both of which have inherent weaknesses. Those weaknesses are discussed in paragraphs A58 - A61 below.

A43. In spite of the inherent weaknesses of summary measures, many of the technical experts and all of the communication experts recommended that summary measures, including a “bottom line” summary measure, are important and should be required. Among other reasons, summary measures are valuable for evaluating proposals and also for comparison of the prior reporting year to the current reporting year. For example, one technical expert said that highlighting changes resulting from such actions as the passage of new entitlement programs should be the “acid test” for any proposed reporting on fiscal sustainability. Such reporting (on whether a projected shortfall increased or decreased during the reporting period) can best be accomplished through the use of summary measures. Furthermore, a study by the Organisation for Economic Co-Operation and Development (OECD) found that 10 of 12 nations producing fiscal sustainability analyses included summary measures.[28]

A44. In order to address the difficulty that some readers may have with summary amounts that are expressed as very large present-value dollar amounts, the Board decided that each line item in the basic financial statement that is displayed in present-value dollar amounts should also be displayed as a percentage of the present value of GDP for the projection period.

A45. A majority of respondents agreed that the Board’s proposed basic financial statement, which requires summary measures, would be understandable and meaningful to readers. However, some respondents expressed the view that trend information is more understandable than summary measures. The Board decided to retain the basic financial statement as proposed in the exposure draft.[29] While users’ preferences among individual items in the fiscal sustainability reporting package will vary, the Board believes that each requirement in the Statement is meaningful and necessary.

Per Capita Measures

A46. The Board considered whether to include per capita measures in the summary display. The technical experts serving on the Fiscal Sustainability Task Force did not come to agreement regarding the display of summary numbers on a per capita, per worker, and/or per household basis.

A47. A majority of the technical experts on the task force recommended against per capita measures, for the following reasons:

[28] OECD draft report, *Fiscal Futures, Institutional Budget Reforms, and Their Effects: What Can Be Learned?*, to be published in OECD Journal on Budgeting in 2009.

[29] See additional discussion of the basic financial statement in paragraphs A32 through A37.

a. Several technical experts strongly objected to the use of per capita summary numbers using current-year population for the denominator. They said that such measures would imply that the current-year population is solely responsible for funding program shortfalls into the distant future. They believe that any changes needed to address the shortfalls projected through, for example, the next 75 years, should be spread across the population throughout that 75-year period.

b. Other technical experts noted that per capita measures may be useful in conveying the magnitude of projected fiscal imbalances and could be displayed if summary amounts are divided by the population that parallels the horizon indicated and a narrative is included that explains present value and the nature of the numerator and denominator.

c. Per capita measures for infinite-horizon projection periods present special problems. It is uncertain how a reasonable per capita denominator for an infinite horizon ratio would be selected and explained, especially if the denominator includes an estimate of all individuals that enter the population during the projection period.

d. Two technical experts believe that even present value per capita amounts can be misinterpreted, because the reader will compare the amount with current salary levels and not understand the role of potential future productivity increases.

e. One technical expert objects to per capita amounts because they represent amounts distributed equally among individuals with widely different abilities to pay.

A48. After a discussion of the above issues, the Board decided not to include per capita measures in the proposed reporting requirements. Several of the respondents to the ED indicated strong support for per capita amounts. Three respondents recommended per capita amounts on the face of the financial statement. One respondent specifically recommended a detailed per capita format titled "U.S. Taxpayer Personal Credit Card Statement."

A49. The Board decided that the technical arguments described in paragraph A47 were compelling and that the standard should not require per capita information.

Time Horizon for Projections

A50. There was strong disagreement among the task force participants regarding the selection of a time horizon for projections, in particular a finite horizon (for example, 75-year) versus an infinite horizon. One task force participant believes that only infinite-horizon projections should be displayed but others believe that infinite-horizon projections should not be shown. Some participants suggested that information using both finite and infinite-horizon projections be included.

A51. A majority of the communication experts believe that information for both finite and infinite-horizon projections should be provided to readers, but not necessarily both within a primary display.

A52. Arguments in favor of a finite horizon:

a. A finite period would be sufficient to cover essentially all of the working and retirement years for current participants.

b. A finite period is subject to less uncertainty than an infinite horizon.

c. A finite period is meaningful to readers. For example, readers can relate to a time period that will include the retirement of the youngest members of the current workforce. An infinite horizon is less meaningful to readers. Readers are less likely to relate to or be concerned about the U.S. Government's fiscal condition in 200, 500, or 1,000 years in the future.

d. Infinite-horizon projections are no more informative to policymakers than 75-year projections, in part because projections beyond the 75-year horizon are subject to significant uncertainty. A more detailed version of this argument is made in an article in the National Tax Journal:

> …many people already believe that the 75–year horizon is too distant to be meaningful, and that detailed projections over longer horizons suggest a false precision. A simpler projection assumption is that after 75 years (or some other interval, T), the system will have settled into a steady state in which rates of growth of costs and tax revenues are thereafter constant, although not necessarily equal.[30]

A53. Arguments in favor of an infinite horizon:

a. Unless trends are level towards the end of the period, projections may be subject to the "moving window" effect, where shortfalls (or surpluses) increase significantly from one reporting year to the next due to the change in the projection period. For example, if a projection period is 75 years, the activity in "year 76" is outside the projection period for that year, but will be included in the projection period for the following year. An infinite horizon would avoid the "moving window" effect that occurs when there are significant

[30] *Sustainable Social Security- What Would It Cost*? National Tax Journal, Vol. LVI, No. 1, Part 1, March 2003, page 34. Available at http://ntj.tax.org /wwtax/ntjrec.nsf/5DC0004871203048856D8E0054C858/$FILE/Lee.pdf (accessed May 7, 2009).

changes to an estimate from one year to the next that are caused by the passage of time.

b. Some have argued that a finite projection period essentially assumes zero for years beyond the projection period. Infinite-horizon projections would not assume zero for years beyond the cutoff point for projections.

A54. The Board believed that the advantages of both finite and infinite horizons were sufficiently compelling to propose in the ED that both finite and infinite-horizon information should be provided, although only one projection period should be used for the basic financial statement. The ED proposed that whichever type of projection period is selected for the primary display, the other type of projection period would have been presented with the disclosures.

A55. The Board also believed that one of the projection periods used (in either the basic financial statement or the narrative section) should be consistent with that used for the SOSI. This would ensure consistency between major line items in the SOSI (for example, projected earmarked receipts and spending for Social Security and Medicare) and corresponding line items in the basic financial statement or the disclosures.

A56. A majority of respondents disagreed with the Board's proposal to require reporting projected data for both finite and infinite time horizons. Respondents said that requiring projected data for an infinite time horizon would be: too much information, irrelevant, and unacceptably uncertain due to many major events that are very difficult or impossible to predict, such as depressions, natural disasters, and wars. A majority of respondents disagreed with the Board's proposal not to specify a time horizon for projected data. Several respondents recommended a specific time horizon of 75 years.

A57. The Board decided not to require reporting on the infinite horizon and to explicitly require a finite horizon for the basic financial statement. The Board addressed the issue of trends beyond the end of the projection horizon by adding a requirement that the RSI should discuss the implications of the sustainability information, particularly the information in the basic financial statement, after the end of the projection period. This requirement may be met by providing projections for an infinite horizon. (See paragraph 42.)

The Concepts of Fiscal Gap and Fiscal Imbalance

A58. The Board considered two potential summary measures for presentation below the other required elements on the basic financial statement or separate disclosure: fiscal gap and fiscal imbalance.

a. The fiscal gap is the change in non-interest spending or receipts that would be necessary to maintain public debt at or below a target percentage of GDP.

b. The fiscal imbalance is the net present value of existing federal debt plus projected non-interest spending,[31] minus projected receipts. In other words, it is the fiscal gap when the target level of federal debt at the end of the projection period is zero. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected non-interest spending, and repayment of debt for a stated projection period.

A59. Several of the Task Force technical experts indicated that the fiscal imbalance, as defined above, overstates the size of the problem over any finite time period such as 75 years. The fiscal imbalance is defined as the existing federal debt plus projected non-interest spending less projected receipts. If projected receipts are large enough to set the fiscal imbalance to zero after 75 years (or any other fixed time period), this would imply the debt was paid off at the end of the period. Many of the technical experts argued that this is not necessary for continued solvency provided the economy is expected to last longer than 75 years. A positive level of debt is viewed by many to be fiscally acceptable at the end of the projection period, provided it is not too large or growing too fast.

A60. The fiscal gap measure does not require a target debt level of zero; instead, it allows for a positive level of debt at the end of the forecast horizon. In order to report the fiscal gap as a single amount (in present value dollars or as a percentage of GDP, projected receipts or projected non-interest spending), a target debt level relative to GDP must be selected. Such a measure would show the magnitude of increases in receipts or cuts in non-interest spending that would be needed to achieve that target. However, any specific limit selected may be considered arbitrary. In the United States, there is currently no legislated goal for debt as a share of GDP or a legislated limit on borrowing other than the statutory debt limit, which has been frequently raised.

A61. Since the Board has no objective basis for selecting a debt-to-GDP limit or goal, the requirements for information about the fiscal gap do not include a specific debt-to-GDP limit or goal. Fiscal gap should be explained and reported, either on the face of the financial statement or in the disclosures.

[31] Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest.

Foreign Holdings of U.S. Treasury Debt

A62. A significant minority of members supported a proposal that the proportion of U.S. Treasury debt held by foreign investors is also important information and should be reported as RSI. They point out that while it is important to report the large and growing gap between receipts and spending, the extent to which deficits are being financed by foreign lenders is also significant information, particularly in light of the large and growing increase in that proportion.

A63. The members supporting this additional requirement pointed out that foreign lenders cannot be counted on to be always willing to finance the government's deficits; that the magnitude of this indebtedness to foreign lenders has national security implications, including threatening our international standing and influence and limiting our foreign policy options; and it results in the interest payments on the debt going abroad instead of providing income to U. S. residents and feeding into our economy.

A64. The members supporting this additional requirement therefore proposed that RSI should include an illustration and/or explanation of the trend in foreign holdings of U.S. Treasury debt for a minimum of 15 years through the most recent date for which data are available.

A65. A majority of members believed that there should not be a requirement to report foreign holdings of U.S. Treasury debt, for reasons that included the following:

a. It is unclear how the information relates to the fiscal sustainability of current policy without change.

b. Information on foreign holdings of U.S. Treasury debt is based upon unaudited, unverifiable surveys rather than transaction records and is not available on a timely basis.

c. A reporting requirement for existing foreign holdings would repeat information readily available in other places.

A66. A majority of respondents agreed with the minority proposal to require reporting of foreign holdings of U.S. Treasury debt. Among the reasons given were:

a. This information would show the reader the impact foreign countries could have on the U.S. economy.

b. Trends in the proportion of U.S. Treasury debt held by foreign investors are a fundamental user consideration.

c. This is a very important financial issue that can have significant economic, fiscal, foreign relations and even national security implications over time.

d. Graphic information (like the pie chart in #10, Appendix B of the ED) regarding trends in the proportion of U.S. Treasury debt held by foreign investors (especially foreign countries) should be made part of RSI *and* be subject to the phased-in implementation. The respondent feels strongly about this because of our increasing reliance on foreign countries to fund our operating deficits at a time when the global economy is under great strain and these funds may not be available to us in the future as countries like China, Japan, and Germany are forced to shore up their own economies, especially with further global economic deterioration.

A67. The Board decided not to include a requirement to report on foreign holdings of U.S. Treasury debt for reasons described in paragraph A65.

Alternative Policy Proposals

A68. A minority of members supported a proposal for additional RSI (not subject to the phased-in implementation in paragraph 45) that they believed would increase the likelihood that the financial statement and disclosures will result in important and necessary decisions. These members proposed that if the Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant imbalance, the basic financial statement should be accompanied by an identification of one or more policy alternatives that would close the fiscal gap. The identification, explanation, and fiscal impact of the policy alternative(s) would be presented as RSI.

A69. A majority of members believed that there should not be a requirement to describe policy alternatives because a statement of accounting standards is not the proper venue for requiring policy proposals.

A70. A majority of respondents agreed with the Board majority view.

Inter-period or Inter-generational Equity

A71. The Board also considered information that may be helpful to readers in assessing whether financial burdens without related benefits were passed on by current year taxpayers to future year taxpayers (sometimes referred to as “inter-generational equity” or “inter-period equity”).

A72. In addition to measuring whether projected future receipts are sufficient to support projected future spending, it is important to understand how the financing of future spending affects current and future-year taxpayers. For example, even if projected receipts equal projected spending over the time horizon of the projections, policy may be such that future-year taxpayers assume a higher burden of taxes or lesser public services than current-year taxpayers.

A73. To present such information, a narrative could explain how measures such as debt to GDP over the time horizon of the projection indicate the extent that current deficits are left to be financed by future-year taxpayers either through increased taxes or decreased benefits.

A74. While a minority of the Board believed that such disclosures should be required, the majority of the Board decided to provide that such information is an optional way to meet the disclosure requirement to provide information that puts the data into context (see paragraph 42).

A75. A majority of respondents agreed with the Board majority view.

Other comments

A76. Several respondents raised fundamental questions regarding the project. One respondent said that unlike private entities, the government is sovereign; it has the power to tax and issue money; accordingly, the federal government is unlikely to lack sufficient budgetary resources to sustain public services and to meet obligations as they come due. However, even that respondent noted that government spending can indeed become excessive.

A77. Another respondent said that the concept of sustainability should not require assumptions about what the American people want to do. For example, if 40 years from now citizens decide that 30 percent of GDP may be appropriate to address a large elderly and/or disabled population, the Board should not assume that this would be impossible or unsustainable. That respondent also said that to show income taxes as a flat percentage of GDP while we show the cost of entitlements rising with the law is inconsistent and shows an unintended bias. That respondent indicated that even a very small adjustment would put Social Security into balance.

A78. The Board decided that the proposed standard may not have made it sufficiently clear that the reporting consists of projections and not predictions and that the final Statement of Federal Financial Accounting Standards (SFFAS) should explicitly explain the difference between projections and predictions. The following language was added to paragraph 39c:

> [39] Disclosures should include an explanation of the following limitations:
>
> > [c] Projections are <u>not</u> forecasts or predictions; they are designed to answer the question “what if?” – for example, what would be the impact on federal borrowing if current policies without change were continued for a long period of time?

Board Approval

A79. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB office.

Appendix B: Example Formats and Illustrations

The examples in this Appendix are illustrative only; they do not represent authoritative guidance.

Basic Financial Statement

Long-Term Fiscal Projections for the U.S. Government

Amounts projected to 75 years

	As of XXXX XX , 20XX (Current Year)		**As of XXXX XX, 20XX (Prior Year)**		**Change from Prior Year**	
	PV Dollars *in trillions*	**% of the PV of GDP***	**PV Dollars *in trillions***	**% of the PV of GDP***	**PV Dollars *in trillions***	**% of the PV of GDP***
Receipts						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
All Other Receipts	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Receipts	$ XXX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Non-Interest Spending						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Medicaid	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program A	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program B	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Non-Interest Spending	$ XXX.X	X.X.%	$ XX.X	X.X%	$ X.X	X.X%
Non-Interest Spending in Excess of Receipts	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%

* GDP (Gross domestic product) can be roughly defined as all of the nation's income or everything the country produces.

** Rest of government: The repayment of borrowings by the general fund from the trust fund accounts for Social Security and Medicare are included in Receipts for Social Security and Medicare, and Non-Interest Spending for Rest of government.

To maintain the current [or date] level of U.S. Treasury debt held by the public to GDP, actions would need to be taken to increase receipts or decrease non-interest spending by a net present value of $XX.X trillion or X% of GDP. To accomplish this reduction, annual receipts would need to increase by XX.X% or annual non-interest spending would have to decrease by XX.X% (or some combination of these two options).

Note: Amounts are estimated based upon guidance for selecting assumptions provided in this Statement. Receipts and non-interest spending include repayment of borrowings from the trust fund accounts for Social Security and Medicare (estimated as 0.X percent of GDP).

Examples of Selected Narrative and Graphics

The following examples display and/or describe narrative and graphics that might supplement the basic financial statement in a manner consistent with the standard.

These illustrations are illustrative only and do not represent authoritative guidance. Illustrations are not provided for all requirements.

Examples are provided in this appendix for the following:

1. Rising Cost of Health Care

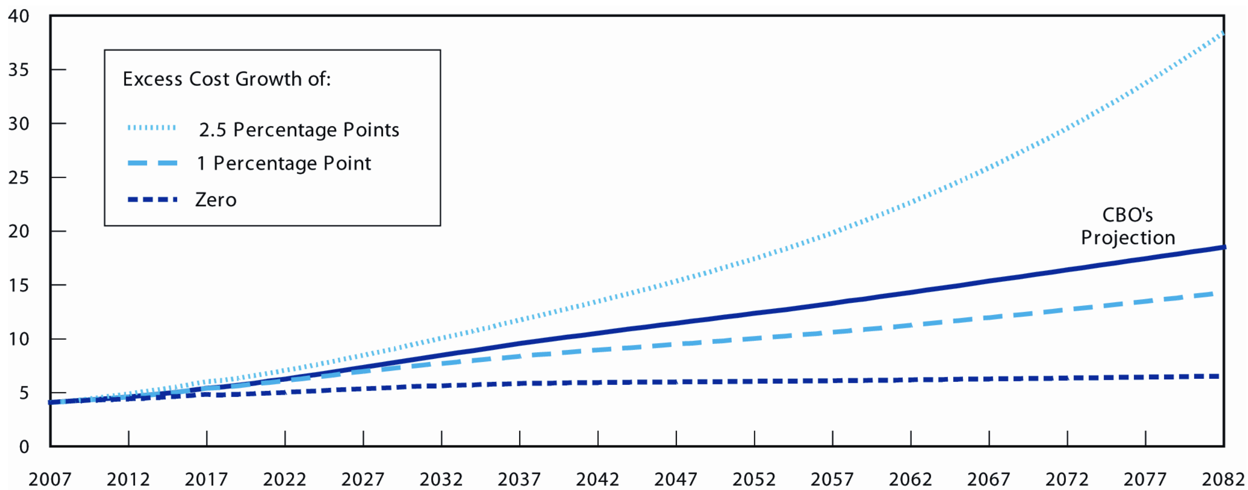
Paragraph 41b provides that RSI should explain and illustrate major factors that are expected to have a significant impact upon future receipts and spending. For example, if rising federal spending on health care is a major factor in the long-term spending projections, the disclosure might include the following:

a. If the growth in health care spending exceeds the growth in GDP, a narrative might explain that the growth in any spending program cannot continue indefinitely to exceed the growth in the economy, because at some point, the spending would exceed the resources that can be extracted from the economy.

b. A range encompassing projections for major factors affecting future spending such as the rising cost of health care might be presented in a graphic as a percentage of GDP. The graphic could use the example format in Illustration 1a or other formats

Illustration 1a: Major Cost Drivers for Federal Spending

Federal Spending for Medicare and Medicaid as a Percentage of Gross Domestic Product Under Different Assumptions About Excess Cost Growth



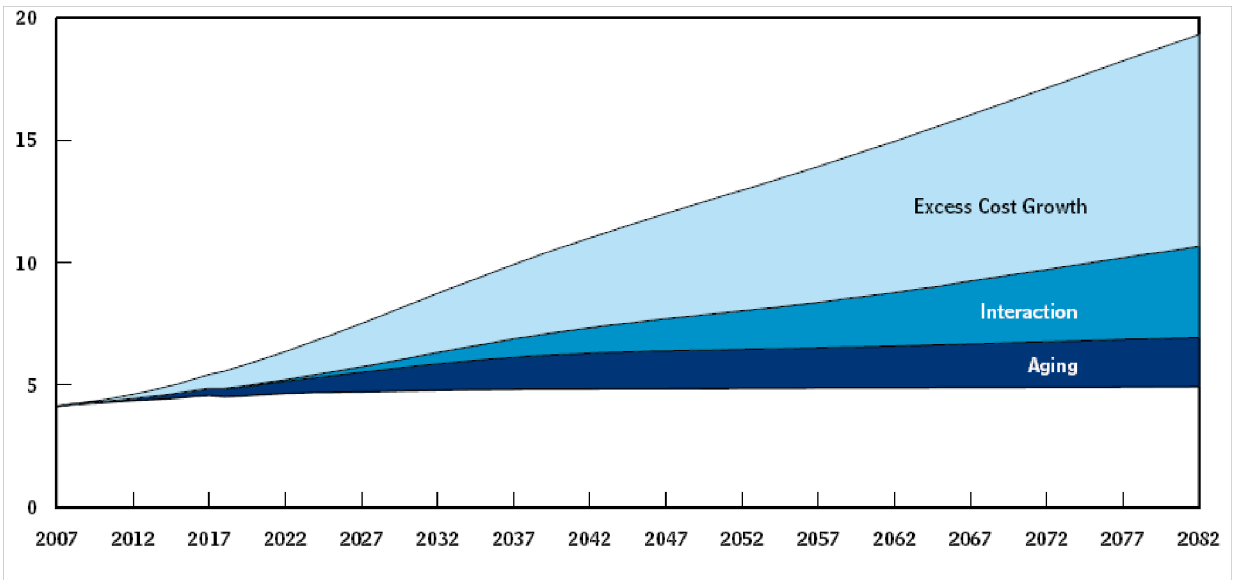
Source: Congressional Budget Office, *The Long-Term Outlook for Health Care Spending* (November 2007) Figure 5, page 15. Available at: http://www.cbo.gov/ (accessed May 7, 2009)

"Excess Cost Growth" refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

In addition, a graphic might display the relative contribution of two or more major cost drivers. For example, Illustration 1b displays the effect of the aging of the population, excess cost growth, and the interaction of those two factors on federal spending on Medicare and Medicaid.

Illustration 1b: Relative Contribution of Two Major Cost Drivers

Allocation of Projected Growth in Federal Spending on Medicare and Medicaid, by Source
(Percentage of gross domestic product)



"Excess Cost Growth" refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

"Interaction" is the interaction of the aging of the population combined with projected excess cost growth. In other words, both conditions (excess cost growth and aging of the population) are necessary for the cost growth labeled "Interaction" to occur.

"Aging" is the projected increase in federal spending on Medicare and Medicaid that is attributable solely to the aging of the population.

Source: Adapted from Figure 1 of "Accounting for Sources of Projected Growth in Federal Spending on Medicare and Medicaid," Economic and Policy Issue Brief, May 28, 2008. Available at: http://www.cbo.gov (accessed June 1, 2009).

2. Demographic Trends

Paragraph 41b requires that RSI explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government, one example of which may be demographic trends. The narrative might describe demographic trends and briefly explain the major drivers of change in demographic trends, for example, trends in longevity and birth rates, and refer the reader to more extensive coverage of the topic in other existing reports, for example, the Social Security and Medicare Trustees Reports. The narrative could describe the change in the ratio of workers to retirees and how this change relates to long-term fiscal outlook for social insurance programs. Alternatively, simple age demographics rather than workforce participation could be used (in other words, “over 64” instead of “retired”) provided that they are used consistently.

A simple graphic to accompany and illustrate the narrative may follow the format of the example shown below. The illustrative sample format below is called an “age/gender pyramid.” The graphic could display two or three age/gender pyramids side-by-side, for example:

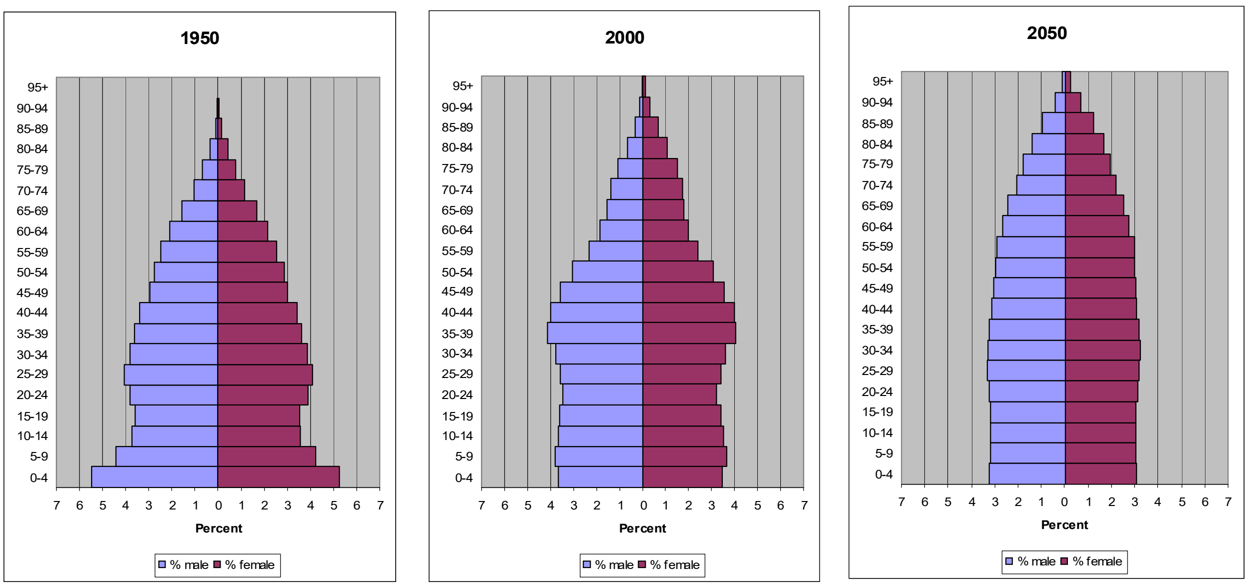
1. the current (or other baseline) year minus 50 years;

2. the current year (or other baseline year, for example, 2000); and

3. a projection of the current (or other baseline) year plus 50 years.

Illustration 2: Age-Gender Pyramid

The Changing Shape of the United States' Population



Source: *Social Security Administration, Area Population Statistics.*

The narrative could also discuss the "total dependency" ratio (dependent children plus retirees per worker) for each "worker-to-retiree" ratio that is provided in the narrative.[32]

The narrative also could provide perspective by explaining that similar demographic trends are occurring in other developed countries, and provide examples of developed nation(s) projected to have a greater number of retirees per worker than the United States, and developed nation(s) projected to have fewer retirees per worker.

[32] The European Commission defines the total dependency ratio as the "Population under 15 and over 64 as a percentage of the population aged 15-64." *European Economy: Special Report 1/2006*, page 313.

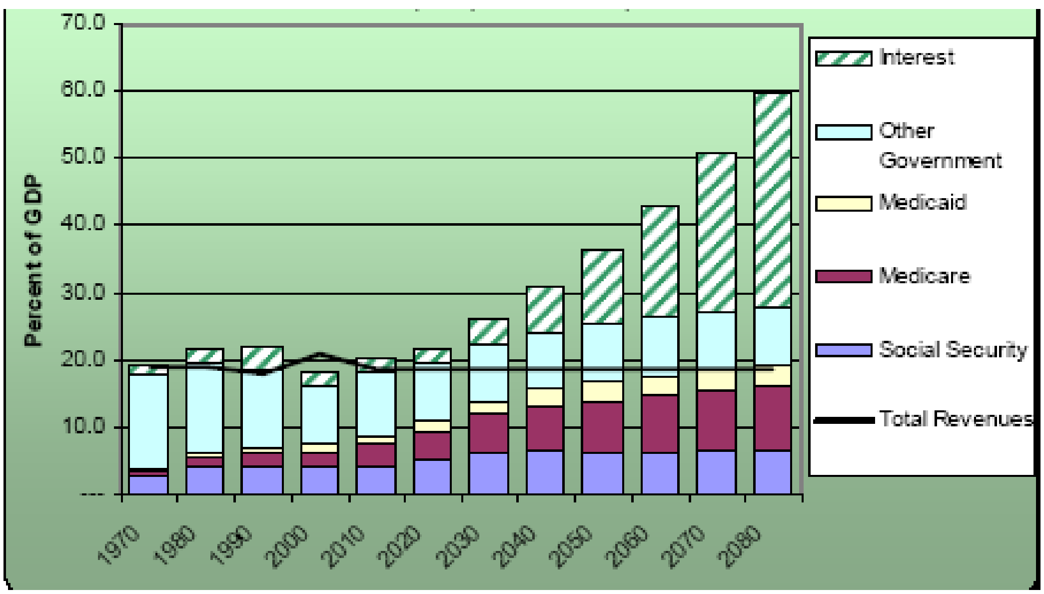
Paragraph 41a requires that RSI explain and illustrate the historical and projected trends for a progression of years. Illustrations 3, 4 and 5 display how this might be accomplished.

3. Relationship of Projected Receipts and Spending

The RSI section could include a graphic of the relationship between projected receipts and spending for a progression of years, for example beginning 20 years before the current year and extending to all future years projected in the basic financial statements. Below is an example.

Illustration 3: Projected U.S. Government Receipts and Spending

Projected U.S. Government Receipts and Spending
(As a percent of GDP)

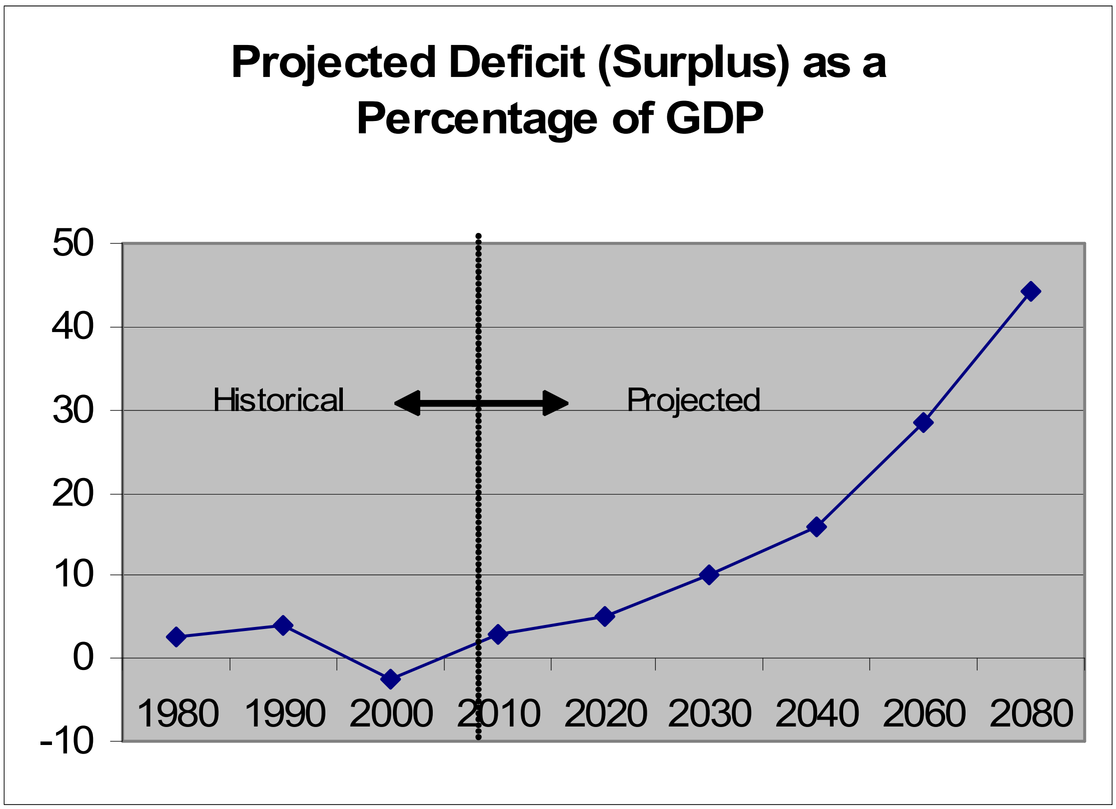


Source: FY 2007 *Financial Report of the U.S. Government*, Chart H, page 18. Available at http://fms.treas.gov/fr/index.html (accessed May 7, 2009).

4. Trends in Deficit Spending

The trends in deficit spending could be graphically displayed as a percentage of GDP for a progression of years, for example beginning at least 20 years before the current year and extending to all future years projected in the basic financial statement.

Illustration 4: Projected Deficit/Surplus as a Percentage of GDP



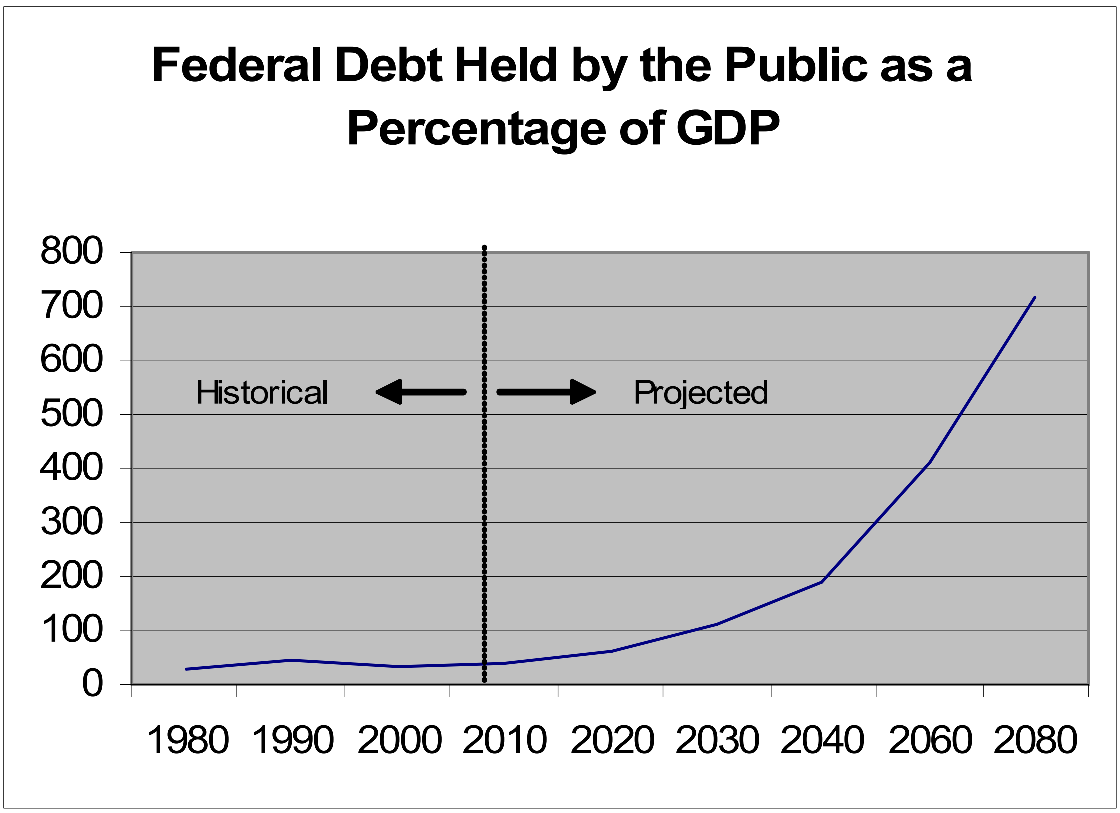
Data sources:
Historical: Office of Management and Budget, Table 13-2, Chapter 13, “Stewardship,” *Analytical Perspectives*, FY 2008 Budget

Projections: Government Accountability Office, Long-Term Fiscal Simulation Data, Alternative Scenario. Available at: http://www.gao.gov/special.pubs/longterm/data.html (accessed May 7, 2009)

5. Trends in Treasury Debt Held by the Public

A graphic could display the projected trends in Treasury debt held by the public as a percentage of GDP, for a progression of years beginning at least 20 years before the current year and extending to all future years projected in the basic financial statement. This graphic could illustrate the assumption that increased borrowing would occur to finance the difference between projected receipts and spending.

Illustration 5: Increase in Federal Debt Held by the Public



Data sources:
Historical: Office of Management and Budget, Table 13-2, Chapter 13, “Stewardship,” *Analytical Perspectives*, FY 2008 Budget
Projections: Government Accountability Office, Long-Term Fiscal Simulation Data, Alternative Scenario. Available at: http://www.gao.gov/special.pubs/longterm/data.html (accessed May 7, 2009).

6. Impact of Delaying Action

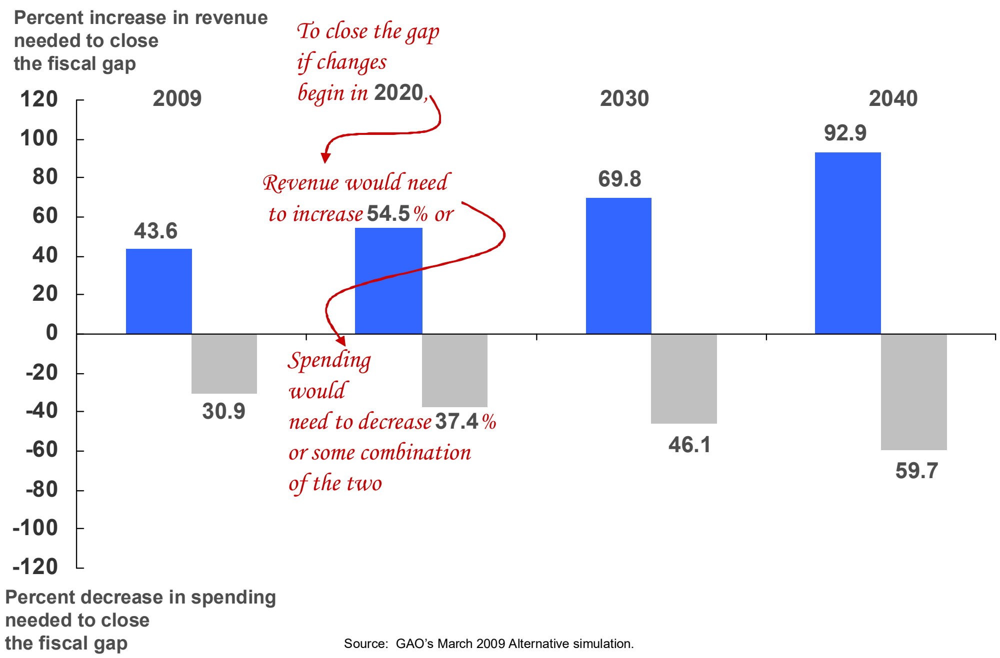
Paragraph 41c provides that if the projections indicate an excess of projected non-interest spending over projected receipts, RSI should explain and illustrate the likely impact of delaying action. A graphic could display the progressive increase in the change that would be needed to close the fiscal gap by (a) reducing non-interest spending or alternatively (b) by increasing taxes.

Illustration 6: Impact of Delaying Action

What are the Costs of Delaying Action?

How soon action is taken will affect how much the government would have available to spend on various priorities. The measures below show, for each of the years presented, how much the government would have to immediately and permanently either raise receipts or cut non-interest spending – or some combination of the two – to close the fiscal gap* if action begins in that year. For example, if action does not begin until 2040, non-interest spending would have to be permanently reduced by 59.7% or receipts increased by 92.9% (or some combination of the two) relative to 2009 levels of spending and receipts.

*In this projection, "closing the fiscal gap" means to maintain the government's debt at the same size (in relation to the economy) as it was at the beginning of the projection period.



Source: GAO's March 2009 Alternative simulation.

7. Alternative Scenarios (Range Information)

Paragraph 41d provides for the explanation and illustration of alternative scenarios consistent with current policy without change. It indicates that a table may be used to display alternative scenarios. The following illustration is an example of how such a table might be displayed.

Illustration 7: Alternative Scenarios

	Statement	Alternative 1	Alternative 2
Receipts:			
Medicare			
Social Security			
All Other			
Total Receipts			
Spending:			
Medicare			
Medicaid			
Social Security			
Major Program A			
Major Program B			
Rest of Government			
Total Non-Interest Spending			
Non-Interest Spending in Excess of Receipts			

8. Fiscal Gap

Paragraph 38 requires that information about fiscal gap be included on the face of the basic financial statement or in the disclosures. The fiscal gap is the change in non-interest spending or receipts that would be necessary to maintain public debt at or below a target percentage of GDP. An illustrative narrative disclosure on the face of the basic financial statement for the change in non-interest spending or receipts necessary is shown on page 32.

The following is an example of an explanation of the concept of fiscal gap that may be useful in putting the information required by paragraph 38 into context:

> How much public debt is sustainable? While many experts agree that some level of public debt is reasonable and acceptable, there is no universally agreed-upon "sustainable" percentage of debt to GDP. However, all experts agree that a continually

increasing level of debt to GDP is not sustainable. The chart in Note X[33] displays how the debt as a percentage of GDP has varied over time. Debt was 36.8% of GDP as of September 30, 2007, but has risen as high as 109% of GDP (during World War II). Many economists believe that persistent debt-to-GDP levels over 100% are unhealthy.

9. Disclosure on Funding Mechanisms

Paragraph 40f requires a discussion of the different funding mechanisms for major programs that are not primarily funded by the government's general revenues. Below is an illustrative disclosure.

Of the $XX of the net excess of non-interest spending over receipts, $YY relates to programs funded by the government's general revenues and $ZZ relates to Social Security (OASDI) and Medicare Part A programs, which are funded by payroll taxes and which are not funded in any material respects by the government's general revenues. If payroll and self-employment taxes and related assets in the Federal Old-Age and Survivors and Disability Insurance (OASDI) Trust Funds or Federal Hospital Insurance Trust Fund (Medicare Part A) become insufficient to cover related benefits, as indicated by projections, additional funding for each of these two programs would be necessary or scheduled benefits would need to be reduced. If the government's general revenues are insufficient to cover both mandated transfers to Medicare Parts B and D and spending for other general government programs funded by the government's general revenues, as indicated by the projections, either the government's general revenues or Medicare Parts B and D revenues (premiums and state transfers) would need to be increased, spending for Medicare Parts B and D and/or other general government spending would need to be reduced, and/or additional amounts borrowed from the public.

10. Other Required Information

The illustrations in the appendix are not all-inclusive. Additional information is required by paragraphs 39 - 42 but is not explicitly described or illustrated in this appendix. For example, paragraph 39 requires an explanation of the nature and limitations of projections. Paragraph 42 requires that the narrative should explain the significance of the data presented and put the information into context.

[33] See *Illustration 5: Trends in Treasury Debt Held by the Public on page 1414.*

Appendix C: Frequently Asked Questions (FAQs)

These FAQs were included in the exposure draft to aid respondents. They are not required in the CFR.

FAQ 1. What is “Fiscal Sustainability Reporting”?

“Fiscal Sustainability Reporting” is the short term for “Comprehensive Long-Term Fiscal Projections and Accompanying Narrative and Graphics in the Financial Report of the U.S. Government.”

FAQ 2. What is GDP?

A nation’s gross domestic product, or GDP, is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:

GDP = consumption + investment + government spending + (exports imports)

FAQ 3. a. What is the debt-to-GDP ratio?
b. Why does the debt-to-GDP ratio matter?

a. The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by GDP. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]

b. The debt-to-GDP ratio provides an indication of a nation’s ability to repay its public debt by comparing the size of its debt to the size of its economy. For example, during the formation of the European Union (EU), one of the conditions for initial membership in the EU, which included eligibility to convert its currency to the Euro, was that each nation had to meet certain conditions, including debt-to-GDP ratio. Generally, higher debt-to-GDP ratios are believed to result in lower economic growth and private investment as well as higher interest costs. Many economists believe that persistent debt-to-GDP levels over 100% are unhealthy. In addition, the debt-to-GDP ratio cannot continue to rise indefinitely, because at some point (although the precise point at which this would occur is unknown) the world’s financial markets would likely cease lending to the U.S. government.

FAQ 4. What is present value?

Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent interest (compounded annually), how much do I need to put into the bank today in order to have $110 one year from today?” The amount you would need today would be $100. Therefore, the present value of $110 in this example would be $100.

In present value calculations, the further out in the future the needed amount, the smaller the amount you would need today. In the first year, you earn interest on the amount that you deposit (the “principal” amount). In the second year, you earn interest on both the original principal amount and the amount of interest that was earned in year one. In year three, you would earn interest on:

- the original principal amount, plus
- the interest earned in year one on the principal amount,
- the interest earned in year two on the principal amount, and
- the interest earned in year two on year one’s interest earnings.

This is colloquially called “the magic of compounding.” If inflation is less than the rate of interest earned (in this example, ten percent per year), the “magic of compounding” is an advantage to the party that is earning the interest.

FAQ 5. What are projections?

A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions–for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

FAQ 6. What factors affect projections?

Projections are affected by three kinds of assumptions: policy assumptions, economic assumptions, and demographic assumptions.

- Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address projected spending rules for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.

- Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).
- Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Projections are also affected by uncertainty. The uncertainty may be demonstrated by providing alternative scenarios consistent with current policy without change.

FAQ 7. What is the nature of accounts designated as "trust funds" in the budget of the federal government?

A trust fund account, as the term is used in the budget of the federal government, is a type of account designated by law as a trust fund, for receipts earmarked for specific purposes and the expenditure of those receipts. Hence the meaning of the term differs significantly from its meaning in the private sector. For example, a trust in the private sector necessarily involves a fiduciary relationship. In the Federal government, despite the legislative requirement that the funds be earmarked, earmarked funds (often titled "trust funds" in the federal budget) are distinct from fiduciary activities.[34]

Moreover, in order to reduce confusion between accounts designated as "trust funds" in the budget of the federal government (such as the trust fund accounts for Social Security and Medicare) and private-sector trust funds, FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term "trust fund" for earmarked funds (federal "trust funds") except when referring to the legal title of the fund. SFFAS 27 also requires the following note disclosure when accounts designated as "trust funds" in the budget of the federal government use their excess funds to buy Treasury securities:

- 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. (For some funds, the drawdown 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.

[34] Fiduciary Activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*.

- When the earmarked fund's Treasury securities are redeemed to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.[35]

[35]See SFFAS 27, *Identifying and Reporting Earmarked Funds*, paragraphs 16 and 27.

Appendix D: List of Abbreviations

CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FAQ	Frequently Asked Question
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office (formerly, General Accounting Office)
GDP	Gross Domestic Product
IPSASB	International Public Sector Accounting Standards Board
OASDI	Old Age, Survivors and Disability Insurance (Social Security)
OECD	Organisation for Economic Co-Operation and Development
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOSI	Statement of Social Insurance
U.S.	United States

Appendix E: Fiscal Sustainability Reporting Task Force

The FASAB acknowledges with gratitude the invaluable expertise and support of the Fiscal Sustainability Reporting Task Force participants.

The views expressed in this standard represent the views of the FASAB members and should not be attributed to the Task Force participants or to their organizations.

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Statement of Federal Financial Accounting Standards 37: Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements

Status

Issued	April 5, 2010
Effective Date	For periods beginning after September 30, 2010
Affects	• SFFAS 17, paragraphs 26, 27, and 32.
Affected by	None.

Summary

For federal financial reporting, social insurance comprises five programs – Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance. However, two programs, Social Security and Medicare, are of special significance because of the high rate of participation among citizens, the fiscal challenges related to the programs, and the challenges associated with incorporating estimates of future cash flows of this magnitude in financial statements. Therefore, the Federal Accounting Standards Advisory Board (FASAB or "the Board") has devoted substantial resources to considering how fundamental questions about social insurance programs should be addressed through federal financial reporting. These questions include whether the government can sustain these programs as currently constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and how long these programs will be able to provide benefits at current levels.

From the outset of this project, members have agreed on the objectives of financial reporting for social insurance programs and yet have had different views about how best to achieve the objectives. For example, all members have agreed that it is extremely important to provide useful financial information about the sustainability of social insurance programs, and that such information should be presented for the government as a whole in the consolidated *Financial Report of the United States Government*.[1] Members have agreed that social insurance information should be included in the basic financial statements and should be "transparent" – that is, readily understandable to an interested, non expert reader. Members also have agreed that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. All members have supported several innovations, including a new basic financial statement presenting changes in the amounts presented on the statement of social insurance. However, members have had different views about what should be reported on certain financial statements.

[1]To that end the Board recently issued Statement of Federal Financial Accounting Standards 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*.

The key difference among members is in regard to the timing of the recognition of expense and liability for social insurance programs. Some members believe that an expense is incurred and a liability arises for social insurance programs during the working lives of participants, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability. Other members agree with Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, that an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the amount is "due and payable."

This Statement of Federal Financial Accounting Standards represents a compromise. It provides enhanced reporting but does not resolve the two strongly held views regarding when the obligating event occurs for social insurance programs and, thus, when the liability and expense definitions are met within those programs. Therefore, this Statement does not change the liability and expense recognition and measurement from that required in SFFAS 17.[2]

SFFAS 17 requires certain information about social insurance programs, and this Statement requires the following:

- Critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the long-term fiscal projections together in one section in management's discussion and analysis (MD&A).[3]
- A table or other singular presentation of key measures in MD&A.
- A new summary section for the statement of social insurance.
- A new basic financial statement to present the reasons for changes during the reporting period in the open group measure reported on the statement of social insurance.

Although opinions continue to differ regarding when the obligating event occurs for social insurance programs, and thus the question of when the liability and expense occur within those programs continues to be discussed, this Statement fulfills a desire held by all the members to present other information that will significantly improve readers' understanding of the status and results of the government's social insurance programs.

[2]SFFAS 17 established a "due and payable" liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the 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 is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims incurred but not reported.

[3]This Statement applies only to the government-wide entity and to component entities that prepare a statement of social insurance.

Table of Contents

Introduction

Purpose

1. Federal financial reporting should provide accurate and transparent information to citizens so that they can make well-informed decisions for themselves and their government. In this regard, such reporting must include information on the government's long-term commitments for social insurance as well as all other government programs. This Statement of Federal Financial Accounting Standards (SFFAS or Statement) supports that objective.

2. This Statement amends sections of SFFAS 17, *Accounting for Social Insurance*. In addition to the current requirements in SFFAS 17, the standard requires the government-wide entity as well as entities that present a statement of social insurance (SOSI) to:

    a. include in one section of management's discussion and analysis (MD&A) information[4] about costs, assets and liabilities, social insurance commitments, budget flows, and long-term fiscal **projections**; [5]

    b. include in MD&A a table or other singular presentation of key measures drawn from the basic financial statements;

    c. add a section within the SOSI that summarizes the net **present values** of cash flows and presents certain subtotals and totals (see Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI); and

    d. present a statement of changes in social insurance amounts (SCSIA) that indicates the reasons for changes in the open group measure from the end of the previous reporting period (see Appendix D: Illustrative Statement of Changes in Social Insurance Amounts).

3. The federal financial reporting model is unique. The model includes, in addition to a balance sheet and statements of net cost and changes in net position, unique financial statements designed specifically for the federal government, including a statement of budgetary resources, a SOSI, and a statement of long-term fiscal projections for the U.S. government.

[4]This Statement applies only to the government-wide entity and to component entities that prepare a statement of social insurance.

[5]Terms defined in the Glossary are shown in **bold-face** the first time they appear.

In addition, MD&A is a required component in federal financial reports. This Statement provides for additional reporting within this model.

Background

4. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, the federal government is unique when compared with any other entity in the country. In SFFAC 1, the Board established four major reporting objectives for federal accounting standards. The objectives deal with (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control.

5. Although all four of the objectives are equally important, Objectives 2 and 3 guided the development of the social insurance standard. Objective 2 states that 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.

6. Objective 3 states that federal financial reporting should assist users in assessing the impact of the government's operations and investments for the period and how the government's and the nation's financial condition has changed and may change in the future. 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.

7. In light of Objective 3, fundamental questions about social insurance programs should be addressed by accounting standards, including whether the government can sustain these programs as currently constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and how long these programs will be able to provide benefits at current levels. The information that is proposed will help users address these questions.

8. The SOSI was a first step in the process of developing information for an assessment of sustainability of specific programs in government-wide financial reports and in the financial reports of component entities that administer social insurance programs. The SOSI is based on long-range actuarial estimates of future costs. SFFAS 17 requires certain supplementary information as well, including presentations of future cash flow as a percentage of taxable payroll and Gross Domestic Product (GDP). The SOSI and required supplementary information (RSI) provide information that helps users analyze the effect of benefit payments to different participants under current law, as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

9. Social insurance involves major programs. They are not only a component of federal operations, but an essential part of the national economy. This Statement requires information that is not currently provided. Specifically, it requires management to discuss and analyze in MD&A measures of social insurance in the context of other measures presented in the basic financial statements. In addition, it requires a table or other singular presentation of measures in MD&A; a new summary section for the SOSI; and a new statement of changes in social insurance amounts.

Materiality

10. 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 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

11. The provisions of this Statement will be effective beginning in fiscal year 2011.

Accounting Standard

Scope

12. This Statement of Federal Financial Accounting Standards (SFFAS or Statement) is applicable to the consolidated financial report of the U.S. government as well as to the financial reports of component entities that present a Statement of Social Insurance (SOSI). Social insurance standards for these entities are provided in SFFAS 17.

13. This Statement amends sections of SFFAS 17. It does not affect provisions of SFFAS 17 that are not explicitly described and illustrated in paragraph 40 of this standard. For the government-wide entity and entities that present a SOSI, the Statement supplements SFFAS 15, *Management's Discussion and Analysis*; it does not affect the MD&A requirements of other entities.

14. The following five programs are the sole programs subject to social insurance amendments adopted through this Statement:

(a) Old-age, Survivors, and Disability Insurance (OASDI or Social Security);

(b) Medicare Hospital Insurance (Medicare HI) (Part A) and Medicare Supplementary Medical Insurance (Medicare SMI) (Part B and Part D);[6]

(c) Railroad Retirement benefits (RRB);[7]

(d) Unemployment Insurance for the general public (UI);[8] and

(e) Black Lung benefits.

Definitions

15. Closed group population

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.

16. Closed group measure

The closed group measure is the net present value of all expenditures to or on behalf of the closed group population (see above) participating in a social insurance program and all contributions or other income from or on behalf of those participants over a given projection period.

[6] Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) created the Medicare Advantage (MA) program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to beneficiaries, and must provide all Medicare-covered services. Many MA plans offer additional Medicare services such as prescription drugs and vision and dental benefits to beneficiaries. The federal government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and would be accounted for accordingly.

[7] Legislation enacted in 1974 restructured railroad retirement benefits into two tiers, so as to coordinate them more fully with Social Security benefits. The first tier is based on combined railroad retirement and Social Security credits, using Social Security benefit formulas. The second tier is based on railroad service only and is comparable to the pensions paid over and above Social Security benefits in other industries.

[8] Pursuant to SFFAS 17, a statement of social insurance is not prepared for the UI program; SFFAS 17 specifies other reporting for the UI program. Thus, for the purposes of this Statement, the UI program is not a "component entity that presents a SOSI."

17. Closed group unfunded obligation

The closed group unfunded obligation is the closed group measure (see above) minus the value of the assets held by the program at the beginning of the reporting period.

18. Current participants

All individuals currently participating in a social insurance program, e.g., for Social Security, those who are 15 years and older and are working or have worked in covered employment and retirees as of the valuation date. An entry age for work in covered employment of 15 years is assumed.

19. Future participants

Individuals who are not currently participating in a social insurance program but who are projected to participate in the future over a given projection period as contributors or beneficiaries or both. For example, for Social Security, future workers and beneficiaries who are under age 15, not yet born, or not yet immigrated as of the valuation date.

20. Open group population

Those persons who, as of a valuation date, are or will be during the projection period participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

21 Open group measure

The open group measure is the net present value of all expenditures to or on behalf of the open group population (see above) and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years.

22. Open group unfunded obligation

The open group measure (see above) minus the value of assets held by the program at the beginning of the reporting period.

Management's Discussion and Analysis

23. Component entities that present a SOSI and the government-wide entity should discuss critical measures from their basic statements in a separate section of their management's discussion and analysis (MD&A). They should explain the significance of key amounts, the

major changes in those amounts during the reporting period, and the causes thereof. In particular, the entity should explain why the changes occurred and what they imply for the program's operation. The entity should explain how costs and commitments incurred during the period were or will be financed. The entity should describe important existing and currently-known demands, risks, uncertainties, events, and conditions—both favorable and unfavorable—that affect the amounts reported in the basic financial statements. The discussion should go beyond a mere description of existing conditions and should encompass the possible future effects of anticipated future events, conditions, and trends regarding social insurance programs. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

24. At a minimum, component entities that present a SOSI and the government-wide entity should present and explain, as described in paragraph 23, the following measures except as noted:

    a. From the statement of net cost and the statement of changes in net position (component entities) or statement of operations and changes in net position (government-wide entity):

        i. Net costs

        ii. Total financing sources and net change of cumulative results of operations (for component entities only) and

        iii. Total revenue and net operating costs (for the government-wide entity only)

    b. From the statement of financial position (balance sheet):

        i. Total assets

        ii. Total liabilities

        iii. Net position

    c. From the statement of social insurance and the statement of changes in social insurance amounts (SCSIA):

        i. The open group measure; the entity should discuss the closed group measure in the narrative and explain how it differs from the open group measure[9] and the significance of the difference

        ii. The change in the open group measure during the reporting period(s)

[9] See the definitions of “closed group” and “open group” in pars. 15-22. The Black Lung benefits program serves a population that is closed to new entrants; therefore, for that program, the open and closed groups would be the same.

d. From the reconciliation of net operating cost and unified budget deficit (for the government-wide entity only): total unified budget deficit or surplus

e. From the statement of long-term fiscal projections (for the government-wide entity only): the net present value of the excess of spending over receipts.

25. In addition, MD&A should present the above measures in a table or other singular presentation (see the illustration for the government-wide entity at Appendix B: Illustrative Table of Key Measures). The closed group measure is not required to be presented in the table or other singular presentation. The table in Appendix B is for purposes of illustration only. The preparer should determine the most effective format for communicating the critical financial information and the reasons for changes during the prior period.

26. Each critical measure above (costs, net position, etc., see paragraph 24) may be disaggregated into sub-measures. For example, regarding assets, component entities may separately present Treasury securities held, and liabilities may be disaggregated into major items, i.e., into line items for employee pension liabilities and other liabilities.

27. The amounts discussed in MD&A for the open group measure should be the same as the amount in the summary section of the SOSI (discussed below and in Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI), and the SCSIA (discussed below and in Appendix D: Illustrative Statement of Changes in Social Insurance Amounts).

Statement of Social Insurance

[*See Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI. There are two illustrations, one for the government-wide entity (Part I) and another for the component entity (Part II).*]

28. The government-wide entity and component entities that present a SOSI pursuant to SFFAS 17[10] should conclude the SOSI with a summary section that presents the closed group measure and open group measure (see Appendix C). The open group measure line item should be the same as lines on the beginning-of-year and end-of-year amounts on the SCSIA (see below and Appendix D).

[10] Currently, these component entities are the Social Security Administration, the Department of Health and Human Services, the Centers for Medicare and Medicaid Services, the Railroad Retirement Board, and the Department of Labor.

29. The summary section of the component entity SOSI should include the assets held by the programs, if any, and totals for the open group unfunded obligation (see Appendix C, Part II, summary section for component entities).

30. This Statement should not be construed to preclude presenting subtotals by age cohort.

Statement of Changes in Social Insurance Amounts

[*See Appendix D: Illustrative Statement of Changes in Social Insurance Amounts.*]

31. The government-wide entity and component entities that present a SOSI should present a SCSIA. The SCSIA will reconcile beginning and ending open group measures and present the components of the changes in the open group measure from the end of the previous reporting period. It should present the significant components of the change, e.g., the change due to the change in valuation period; the interest on the obligation due to present valuation; the changes in demographic, economic, and health care assumptions; the changes in law, regulation, and policy; and the amounts associated with each type of change.

32. The SCSIA should disclose in notes on the face of the statement and/or in notes to the financial statements the reasons for the changes. The reasons should be explained as briefly and simply as possible. The most significant changes should be explained in the entity's MD&A as well as in disclosures associated directly with the SCSIA.

Required Supplementary Information other than MD&A

33. This Statement does not eliminate or otherwise affect the SFFAS 17 requirements for supplementary information[11] except that actuarial projections of annual cash-flow in nominal dollars are no longer required for either component entities that present a SOSI or the government-wide entity.

Valuation Date

34. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("current year") as

[11] SFFAS 17, paragraph 27(1) requires certain long-range projections of social insurance cash-flow.

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. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy reforms had taken place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

35. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from the estimated cost. For example:

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

Sensitivity Analysis

36. The component entity should provide, as required supplementary information, **sensitivity analysis** of the closed and open group measures appropriate for their circumstances.[12] The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The Social Security Administration (SSA), Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure in the SOSI summary. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.

[12] See Actuarial Standards of Practice 32, paragraph 3.5.

37. When choosing an approach for sensitivity analysis, the entity should consider future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report.

38. The government-wide entity should provide a summary of the sensitivity analyses required for component entities.

Government-wide Entity Accounting and Reporting

39. The standard for government-wide accounting and reporting for social insurance programs is the same as that for component entities that present a SOSI unless otherwise indicated. However, the level of detail at the government-wide level should be less than at the component level.

Effect on SFFAS 17

40. The Statement provides additional requirements for presentation, disclosure, and supplementary reporting for social insurance programs. SFFAS 17 is amended as follows to conform to the changes in this Statement:

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.~~

All projections and estimates required by this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("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. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

26A. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from the estimated cost. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate. For example:

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

27 (1) *Cash-flow Projections –* …

~~(a)~~ Actuarial projections of the annual cash-flow~~, in nominal dollars,~~ with amounts reported for at least every fifth year in the projection period. The cash-flow information should show

i. total cash inflow from:

a. all sources and
b. excluding net interest on intra governmental borrowing/lending and

ii. total cash outflow

~~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]~~

For the OASDI and HI programs, the actuarial projections of the annual cash-flows should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

~~[7] Certain 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.~~
~~[8] This requirement does not apply to the RRB, Black Lung, and UI programs.~~

…

(4) *Sensitivity Analysis* –

(a) ~~For a~~All programs ~~except UI, illustrate the sensitivity of the projections and present values required by paragraph 27(1) and 27(3) to change in the most significant individual assumptions. For example, using the entity's "best estimates" 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.~~ should provide sensitivity analysis appropriate for their particular circumstances. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The OASDI, Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure presented in the SOSI summary. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. The entity should state that the amounts of the closed and open group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.

~~(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).~~

32. … (4) *Sensitivity Analysis* – For all social insurance programs, provide a summary of the sensitivity analysis 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.~~

Effective Date

41. This Statement is effective for periods beginning after September 30, 2010.

> 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 of Federal Financial Accounting Standards (SFFAS or “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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Background

A1. Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy. In its 19 years of operation the Board has issued several exposure drafts, a standard, and a preliminary views document related to social insurance reporting as follows:

- A 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*
- A 1998 exposure draft entitled *Accounting for Social Insurance*
- SFFAS 17, *Accounting for Social Insurance*, in August 1999
- A 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which resulted, in 2003, in SFFAS 25 of the same title
- A 2004 exposure draft entitled *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, which resulted, in 2004, in SFFAS 26 of the same title
- A 2006 preliminary views document entitled *Accounting for Social Insurance, Revised and*
- A 2008 exposure draft entitled *Accounting for Social Insurance, Revised*

A2. For SFFAS 17 the Board identified five programs as social insurance programs.

- 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)

A3. The issue of social insurance accounting was addressed in SFFAS 17 through compromise between strongly opposing views. The compromise featured:

a. liability recognition at the point when social insurance benefit payments are due and payable and with revenue and expenses on a cash-flow basis, plus or minus the change in the due and payable liability during the reporting period;

b. a SOSI and accompanying disclosures; and

c. other narrative and trend information, e.g., graphs of long-term cash flow projections using nominal dollars and as percentages of taxable payroll and GDP, the “dependency ratio,” and sensitivity analysis.

A4. Through SFFAS 25 and 26, the Board re-classified the SOSI from “required supplementary stewardship information” to basic information. The SOSI became subject to a full audit in fiscal year 2006 and significant assumptions were required to be disclosed.

A5. SFFAS 17, 25, and 26 substantially improved the information presented in general-purpose external financial reports of the U.S. government and its component entities. However, in 2004 the Board decided to reconsider the question of liability and expense recognition. A majority of members serving at that time concluded that the compromise that produced SFFAS 17 did not recognize the accruing cost of social insurance programs in each reporting period and the accumulated liability for benefits payable at a determinable date under current law. Nor did it fully explain the change in the net present value of program-related cash flows. Hence, in 2004, the Board initiated a new social insurance project, and a *Preliminary Views* document was issued in October 2006.

What the *Preliminary Views* Document Proposed

A6. In the *Preliminary Views* document, the Board presented two views – a Primary View and an Alternative View – of proposed changes in the information provided about the effect of social insurance programs. Under the Primary View proposal, social insurance expense would have been recognized on the statement of net cost when participants become **fully insured** and thus substantially meet the eligibility conditions for future benefits and as scheduled benefits increase due to additional work in covered employment by fully insured individuals.

A7. In addition to changing the expense and liability recognition points, the Primary View would have linked the SOSI amounts with amounts reported for social insurance on the balance sheet and statement of net cost. For the Primary View members, such linkage or "articulation" would have illustrated how the amounts reported on other basic financial statements relate to the present values of the cash inflow and outflow over the next 75 years reported on the SOSI.

A8. The Alternative View in the Preliminary Views document proposed to maintain the recognition and measurement of expense and liability for Social Security, Medicare, and Railroad Retirement programs currently required in SFFAS 17. That is, the entity would recognize a liability and a related expense for social insurance benefits when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods, or services), which includes the point when benefit payments are "due and payable." Thus, under the Alternative View the amounts reported on the balance sheet, statement of net cost, and statement of social insurance presentation would not have changed from what is currently reported under SFFAS 17.

A9. The Alternative View in the *Preliminary Views* document would have added a new basic financial statement entitled the "statement of changes in social insurance amounts," that would show the reasons for all changes during the period in the amounts (net benefits less receipts) presented in the statement of social insurance. The Primary View members agreed in principle that such a statement should be required.

A10. In addition, the Alternative View in the *Preliminary Views* proposed to break new ground. It proposed a new statement of "fiscal sustainability"[13] for the consolidated *Financial Report of the United States Government* (*CFR*) that would provide sustainability information on the entire government, including information necessary to assess the sustainability of social insurance programs and information on **intergenerational equity**, as required supplementary information.

A11. The members supporting the Primary View welcomed and encouraged the development of additional supplementary sustainability information. However, they believed it should be the subject of a separate project because it has implications for a wide variety of issues.

A12. The FASAB subsequently undertook a project on sustainability that resulted in SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*.

[13] SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*, paragraph A3, notes that discussion of long-term fiscal issues has been described in terms of "fiscal sustainability," and that in the exposure draft on that subject the Board's working definition of fiscal sustainability was "the federal government's ability to continue, both now and in the future, current policy without change regarding public services and taxation without causing debt to rise continuously as a share of GDP."

Different Views Regarding the Obligating Event

A13. Supporters of the Primary and Alternative Views differed as to the event or transaction that would trigger an expense and a liability for social insurance programs. The members supporting the Primary View believed that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities.

A14. Members supporting the Alternative View in the *Preliminary Views* document saw a fundamental distinction in financial reporting of exchange transactions, which are voluntary market exchanges of goods and services for a price, and nonexchange transactions resulting from decisions made collectively by the Congress and the President to levy taxes and to authorize programs. They noted that this distinction is made in FASAB concepts, standards, and financial statements, e.g., the statement of net cost, as well as by other standard setters, including the Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB); and that it is also the difference between offsetting collections or offsetting receipts, on the one hand, and governmental receipts on the other hand.

A15. Members who supported the Alternative View in the *Preliminary Views* document believed that although the basis for recognition of a liability and cost for social insurance established in SFFAS 17 (e.g., due and payable) remains appropriate, the set of information required by SFFAS 17 was inadequate. They argued that SFFAS 17 does not (1) recognize important information concerning the fiscal sustainability of social insurance programs, or (2) fully explain the change in the net present value of program related cash flows. They believed that the fundamental nature of social insurance is more complex than the federal government's current accounting model could accommodate.

A16. It is extremely important to note that both the Primary View and the Alternative View in the *Preliminary Views* document called for sustainability reporting. Those members who supported the Primary View believed that the Board should consider additional sustainability reporting in a future project. As noted above, the FASAB subsequently undertook a project on the subject that resulted in SFFAS 36.

Fiscal Sustainability Reporting

A17. After the public hearing on the *Preliminary Views* on social insurance on May 23, 2007 and initial discussions in the summer of 2007, the Board decided to suspend work on the social insurance standard briefly while it developed fiscal sustainability reporting further. The *Preliminary Views* document mentioned the Board's unanimous interest in fiscal sustainability reporting and the Alternative View presented examples of what it might look like.

A18. The Board issued an exposure draft on fiscal sustainability[14] in August 2008, and subsequently a final standard, SFFAS 36, in September 2009.[15] SFFAS 36 requires that the CFR present information that will help readers assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, including social insurance. The Board concluded that this requires presenting current and projected levels of all federal spending, federal receipts, and federal debt in relation to the economy.

A19. The fiscal sustainability standard is comprehensive. It requires:

a. A statement of long-term fiscal projections for the U.S. government, a basic financial statement, in the CFR presenting the present value of projected receipts and non-interest spending under current policy without change for all activities of the federal government, including social insurance; how those amounts relate to projected GDP; and changes in the present value of projected receipts and non-interest spending from the prior year.

b. Supplementary information explaining and illustrating the projected trends in:

   i. The relationship between all federal government receipts and spending,

   ii. Deficits or surpluses, and

   iii. Treasury debt as a share of GDP.

c. Disclosures explaining and illustrating:

   i. The assumptions underlying the projections,

   ii. Factors influencing trends, and

   iii. Significant changes in the projections from period to period.

[14] *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government,* Issued August 29, 2008.

[15] September 28, 2009.

A20. The Board believes that these projections will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, including social insurance obligations.

Social Insurance Revisited: The Exposure Draft of November 2008

A21. Having developed the proposed fiscal sustainability standard, the Board returned to social insurance. In November 2008, the Board issued the exposure draft *Accounting for Social Insurance, Revised* (SI ED). The Board noted in the SI ED that the fundamental difference of opinion on the question of liability and expense recognition for social insurance was reflected in the views of the respondents to the *Preliminary Views* document itself. Indeed, the difference of opinion has persisted since the Board's initial consideration of the social insurance liability question during the development of SFFAS 5 and especially during the development of SFFAS 17.

A22. SFFAS 17 presented a compromise between two strongly held views regarding liability and expense recognition for social insurance programs. For SFFAS 17, the Board concluded that the best approach was to recognize the annual cash flow effects of the social insurance programs in the basic financial statements; that is, revenue is the cash inflow during the reporting period from payroll tax contributions and income tax on social insurance benefits and expenses are the cash outflow during the year plus or minus the change in a "due and payable" liability. However, the Board also required a package of information that it characterized as required supplementary stewardship information (RSSI).

A23. For the RSSI section, the Board required an array of present values by age cohort in what became the statement of social insurance (SOSI). In addition, the Board required other information, e.g., projections of cash flows over long-term projection periods using nominal dollars and as percentages of taxable payroll and GDP.

A24. The Board decided that the "bottom line" of the SOSI should be an open group measure. That bottom line represents the total excess of actuarial present values of future benefit payments over future contributions and tax income for current and future participants over a period sufficient to illustrate long-term sustainability. There had been much debate during the development of the standard over whether to present the open group measure or the closed group measure.

History of the Closed Group Measure

A25. The term "group" simply refers to the participants included in a measure. The "closed group" includes current participants only, e.g., for Social Security, current retirees and covered workers. It does not include future participants; those projected to become participants during the projection period but after the valuation date. It contrasts with the “open group” that does include those who are currently participating and those who will participate in the future during the projection period. The open and closed group measures include all future flows related to the specified group. These measures contrast with an accrued benefit obligation measure which includes only future benefits attributed to past work in covered employment by current participants as of the reporting date.

A26. The closed group measure has been an option for federal financial reporting for a long time. From 1985 through 1994, the closed group measure was disclosed in a footnote in the “prototype” *Consolidated Financial Statements of the United States* (prototype CFS). Before that, from 1976 to 1985, a liability had been recognized for Social Security in the prototype CFS, using a calculation similar to that called for by private sector accounting standards.

A27. Ultimately, for SFFAS 17, the Board decided to develop the SOSI to provide actuarial present values of future contributions and benefits for the open group of participants but not the closed group per se. The Board concluded that the SOSI as constituted would be useful for analysis of sustainability and financial position of social insurance programs.

A28. The vote for SFFAS 17 was not unanimous. Three members dissented. Their dissents focused primarily on the switch from the closed to the open group bottom line. One of the dissenting members said the closed group deficit was a very important measure in evaluating alternative proposals for social insurance financing. Even though SFFAS 17 required instructions in a footnote on how to calculate the closed group measure, the member felt that, if the Board truly wished to establish standards that meet the information needs of citizens, elected officials, and program managers, the standard should require the prominent presentation and explanation of the closed group measure rather than a footnote explaining how to calculate the closed group measure. The member did not see how that could possibly be interpreted as satisfying the mission of the Board.

A29. Another member dissented because he felt SFFAS 17 did not require a clear unambiguous disclosure of a reasonable estimate of the government’s social insurance liability/obligation. That member argued that the due and payable liability would result in a reported financial position that would appear to many as significantly misleading, at best, and clearly not commensurate with the significant financial implications of this critical national issue. The member noted that SFFAS 17 required the net present value of future benefits related to the open group but not the closed group, and that the absence of the specified closed group measure was significant because some suggest that the closed group measure represents an appropriate estimate of the social insurance liability.

A30. Lastly, a third dissenter argued that the removal of the closed group number from the published financial statements removed any forthright indication of the existence of any obligations to participants. He asked what the government's repeated promises meant if there is no obligation to the participating public. He argued that the closed group number is an important indicator of financial stress to be faced by the next generation of Americans, and is a proxy for an economic liability or an "implicit" liability. He mentioned that proposals to add social insurance benefits or increase social insurance taxes or to make other changes in the program should be evaluated by Congress and the public against these absolute numbers and the strength of the government's commitment to honor the indicated obligations. Finally, he argued that the SOSI should be a basic financial statement, which it later became with SFFAS 25 and SFFAS 26.

A31. Some current Board members believe that the closed group measure is the best measure of the social insurance obligation and that the effect of the change in this measure during the reporting period is an economic cost that should be reported on the statement of net cost. However, other members agree that the closed group measure is the best measure of the obligation but do not believe the effect of the change in this measure during the reporting period is appropriate for the statement of net cost. They view future revenues that are included in the measure as contingent revenues, and they believe all other future inflows and/or revenues included in the balance sheet and the statement of net cost relate to earned revenues.

A32. The Board notes that federal credit accounting, insurance accounting, and accounting for which fair value measures are utilized currently incorporate future inflows and outflows in the measure of liability and expense, and that the basis for including future revenue in current year cost and liability measures depends on the obligating event to which they relate. If they relate to a past event, e.g., an insured event, then they are appropriate measures of cost. If they relate solely to a future event, e.g., future insurance policies in the program, then they should be excluded from current costs and from liability measurement. The key is the event not the fact that the cash flow is in the future. They cite current FASAB insurance standards in SFFAS 5[16] that include future revenue when calculating the net liability.

A33. Since the two views regarding liability and expense recognition persisted and the likelihood of achieving a satisfactory majority one way or the other was remote, and since the Board wished to further improve social insurance reporting, the Board concluded that a

[16] SFFAS 5, par. 113: The liability for life insurance includes both the liability for unpaid claims … and a liability for net future policy benefit outflows…. The [latter] represents the expected present value of future outflows to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders. The liability is estimated using appropriate financial or actuarial methods that include assumptions … applicable at the time the insurance contracts are made and in accordance with existing law and related policy …. Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in which the changes occur. …

compromise was necessary. In developing the exposure draft of November 2008 (SI ED), the Board believed that a fair presentation of the financial position, condition, and results of operations requires that the closed group measure be provided as part of a balanced package of information. The Board believed that the closed group measure represents a reasonably good estimate of the net responsibility of future taxpayers, under current laws, to pay benefits to current participants. Although this amount is subject to change due to changing long-range demographics and other factors, it is not as volatile as the computation under the open group measure that includes all current and future participants over a projection period, e.g., the next 75 years. It relates only to individuals who already are participating in the program.

A34. The open group measure represents the net present value of all expenditures to or on behalf of the open group population and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years. It is used to estimate the future financing shortfall in social insurance programs. The closed group measure involves only those participating in the social insurance program at the reporting date. It represents the same measurement methodology as for the open group, applied to a closed population; that is, it is the net present value of all expenditures to or on behalf of the current participants and all contributions or other income from or on behalf of the current participants over a given projection period.

A35. The open group measure is inherently more sensitive to assumptions about the distant future than the closed group measure. The greater sensitivity is inevitably true, despite the best efforts of actuaries, economists, and other professionals involved in making these projections. It is mainly caused by the fact that a closed group decreases 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.

A36. For the SI ED, the Board proposed changes to highlight the closed group number. The SI ED would have required:

a. a discussion and analysis by management of the closed group measure of social insurance along with other critical measures in MD&A;

b. a separate line presenting the closed group measure that would be presented on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications;

c. new summary presentations on the SOSI for closed and open group measures;

d. a new statement of changes in social insurance using the closed group measure;

e. note disclosure of an accrued benefit obligation; and

f. continuation of the projections and other supplementary reporting currently required by SFFAS 17 but with amendments to the display of cash flow information, the valuation date, and the sensitivity analysis.

Again, the SI ED did not propose to change the SFFAS 17 liability and expense recognition standard.[17]

Respondent's Comments on the Exposure Draft

A37. The SI ED received 20 responses as follows:

	FEDERAL (Internal)	NONFEDERAL (External)
Users, academics, others		14
Auditors	1	
Preparers and financial managers	5	

What the Exposure Draft Proposed Regarding the Balance Sheet

A38. Balance sheet presentation raised difficult issues for the Board with respect to the SI ED. In the *Preliminary Views* document of October 2006, the Board had discussed its differing views of liability and expense recognition, views which have been and remain divergent.

A39. For the SI ED the Board proposed a compromise. Instead of changing the "due and payable" liability measure of SFFAS 17, the Board proposed new reporting featuring the

[17] SFFAS 17, paragraphs 22-23 and 30 state that, except for Unemployment Insurance, the government-wide and component entities should recognize a liability (and a related expense) for those social insurance benefits that are due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported. For UI, a liability (and related expense) would be recognized for (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which the states and territories 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. A UI expense will also be recognized for the reporting period for amounts withdrawn from the Federal UTF by states and territories to pay benefits to beneficiaries that pertain solely to the current reporting period. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior reporting period pursuant to this paragraph, items (1) and (2), would not be recognized as an expense of the current reporting period.

closed group measure of the social insurance commitment as the link or common thread among MD&A, the balance sheet, the SOSI, and the new statement of changes in social insurance amounts. Thus, the closed group measure would have been presented, among other places, as a line item on the balance sheet below assets, liabilities, and net position. It would not have been included in the totals for these classifications, but would have been part of a package of information.

A40. In the SI ED, the members who supported this proposal stated their belief that the closed group measure is important for analysis of social insurance. The closed group measure represents the net present value as of the reporting date of the commitment of future social insurance participants and future general taxpayers to provide benefits to current participants over the latter's lifetime, based on the current participants' past and future work in covered employment. The closed group measure also provides a perspective on the financing challenges for the program. It would be relevant to those who are assessing options for dealing with those challenges. The measure would not only draw attention to the challenge but would also quantify it in a way that can support further analysis and decision-making.

A41. The proposed balance sheet reporting would have affected the reporting model. Again, the proposal was to present the closed group measure as a line item on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. The line item was not presented formally as a new element of financial statements within the context of the SFFAC 5[18] definitions, e.g., a "commitment." The Board explained that it was not formally proposing a new definition or concepts underlying a new reporting model at that time. In order to offer improvements in a timely manner, the Board left open certain questions regarding the reporting model and the elements of federal financial reporting. However, the Board indicated there were areas where additional conceptual work would be undertaken.

A42. Members believe that the current concepts need to do a better job of explaining unique federal accounting issues. Concepts need to explain, for example, why the power to tax is not an asset but nonetheless is relevant to assessing the sustainability or the financial condition of the federal government; why current deficits are indeed bad but that the problem is actually long-range rather than short-range; why the timing of a cash flow problem is important, and why the point estimates on the balance sheet have limitations for assessing financial condition. Members believe that the fiscal sustainability reporting established in SFFAS 36 substantially improves the information communicated regarding financial condition. The Board plans to continue to consider reporting concepts in the Financial Reporting Model Phase of its Conceptual Framework Project.

[18] SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.*

A43. The subjects of the balance sheet and the open vs. closed group measures of the social insurance commitment raise fundamental issues. Over the years, some members and others have asked why social insurance should be treated differently than other programs that are funded by annual appropriations, and why social insurance should be selected for the balance sheet but not other programs, e.g., food stamps, school lunches. They do not believe that a strong basis has been established for saying social insurance programs are the ones to highlight through liability recognition and others can be excluded. In this regard some members believed one of the drawbacks of the SOSI is that it does not provide a comprehensive view of government liabilities-commitments-expectations. They note that the information provided pursuant to SFFAS 36 will provide that view.

Respondents' Comments Regarding the Balance Sheet

A44. Respondents opposed a line item on the balance sheet by a margin of more than 2 to 1. Various objections were raised. Some cited the SI ED's Alternative View position that the lack of a clear definition of a "commitment" on the balance sheet makes the line item a source of confusion. Others objected that the closed group measure was misleading regarding the commitment to social insurance participants.

A45. Some objected from the opposite perspective. They objected to the absence of a liability on the balance sheet beyond "due and payable" and found the new line item an unacceptable substitute.

A46. Some respondents who favored a line item on the balance sheet agreed with the Board's argument that it was a compromise between opposing positions.

The Board's Conclusions Regarding the Balance Sheet

A47. The Board was of two views on the question of displaying the closed group measure (or any similar measure) on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. Some members favored the compromise approach and wished to alter the presentation – either through changes to the balance sheet or development of a new basic financial statement. Those who opposed the new line item on the balance sheet argued that readers would not have a basis for understanding the new element on the balance sheet, and/or that the closed group measure is not comparable to amounts reported on the balance sheet, and/or other significant long-term commitments should be presented, and/or the SOSI is adequate. Further, these members were not persuaded that the proposals presented to alter the presentation on the balance sheet by presenting the open group instead of the closed group or to instead create a new basic financial statement were necessary. Thus, since the Board could not establish a clear majority in favor of the new line item, it decided not to go forward with the proposed balance sheet presentation of the closed group measure as a commitment.

A48. The Board then discussed developing a new basic financial statement that would present the key measures from the financial statements in one place. Ultimately, the Board agreed to require the key measures in a table or other singular MD&A presentation, and integrate the work on a new basic financial statement with the Reporting Model Project.

What the Exposure Draft Proposed Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A49. Regarding the statement of social insurance (SOSI), in the SI ED the Board proposed to require the closed and open group measures in a new SOSI summary section of the CFR which the FY 2008 and 2007 CFR provided even though SFFAS 17 does not currently require it. The SOSI summary section provides information about all age cohorts and about the components of the closed and open group measures. For example, the open group measure equals the closed group measure plus the contributions and the benefits of future participants over the 75-year (or other) projection period.

A50. The Board also proposed a new basic statement, the SCSIA that would have presented the changes during the reporting period for the closed group measure. Heretofore the social insurance reporting had not required an analysis of the changes in the social insurance present values. The Board decided that a financial statement illustrating the components of the change would greatly enhance the value of the presentation. The examples of line items/components for the SCSIA in the exposure draft were consistent with the Social Security Trustees' Report (see, for example, the 2007 Trustees' Report, Table IV.B9, page 66).

Respondents' Comments Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A51. A majority of respondents supported a summary section for the SOSI as described in the SI ED. Those that did not support it objected mainly to the presence of the closed group measure as a component of that summary. Their objections to the closed group measure are noted above regarding other issues. Some respondents objected to requiring a SOSI summary section, although they did not disapprove of it in concept. They preferred to allow the preparer to decide whether to include it. Most respondents supported the SCSIA.

The Board's Conclusions Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A52. The Board concludes that the SOSI should have a summary section as described in the SI ED. Although it decided not to go forward with a line item on the balance sheet for the closed group measure, as explained above, the Board is going forward with the MD&A discussion and associated table or other singular presentation of key measures and with the SCSIA. Thus, the closed group measure and the open group measure continue to be fundamental information. The summary section of the SOSI will illustrate the components of these measures and how the closed group measure relates to the open group measure.

A53. The summary will present both the net present value of the commitment to the current participants (the closed group measure) and to all participants (the open group measure) over the projection period. The Board decided that the closed group measure should be presented on the SOSI – and addressed in MD&A – to enrich the discussion of the open group measure and to give the reader a better understanding of the generational implications of financing social insurance programs.

A54. The Board concludes that the SCSIA will greatly enhance the value of the presentation and should be required since it has substantial support in the community as well as among Board members.

What the Exposure Draft Proposed Regarding Management's Discussion and Analysis

A55. As stated above, the Board provided MD&A standards and guidance in SFFAC 3, *Concepts for Management's Discussion and Analysis* and SFFAS 15. SFFAC 3 provides concepts and a foundation for the standards presented in SFFAS 15.

A56. The MD&A standards in SFFAS 15 are brief. SFFAS 15 requires the entity's financial report to include MD&A, which it categorizes as RSI. SFFAS 15 requires the entity's MD&A to contain sections that address the entity's mission and organization structure, performance goals and results, financial statements, and systems, controls, and legal compliance.[19] It also requires MD&A to include forward-looking information regarding the possible future effects of the most important <u>existing</u>, currently-known demands, risks, uncertainties, events, conditions, and trends, while encouraging forward-looking information about the possible effects of <u>anticipated</u> future demands, events, conditions, and trends.[20] SFFAS 15

[19]SFFAS 15, par. 2.

[20]SFFAS 15, par. 3 and 21.

does not specify the contents for each section. SFFAC 3 provides some concepts in that regard.

A57. For the SI ED, the Board proposed to provide additional specific standards for the financial statement analysis section of MD&A for the government-wide entity and for component entities that present a SOSI. Based on SFFAC 3,[21] the Board proposed that, in the section devoted to financial statement analysis, management should explain critical measures and key amounts and why changes occurred and what the change indicates or implies for the program; and, how the costs and commitments incurred will be financed.

A58. In addition, in the SI ED the Board proposed to require forwarding-looking information about anticipated future demands, events, conditions, and trends related to social insurance. In SFFAC 3, the Board had said management should include information about anticipated future demands and events "to the extent feasible and appropriate." [22] In the SI ED, the Board proposed to require discussion of anticipated events, demands, etc.

Respondents' Comments Regarding MD&A

A59. The respondents favored the MD&A requirement by a margin of about to 2 to 1. Those who favored the standard mentioned the benefits of management's analysis of key measures and of greater transparency. Almost all agreed that key or critical measures should be discussed in MD&A.

A60. Some respondents objected to aspects of the MD&A requirement. Some objected to the focus on the closed group measure which, as noted elsewhere, many assert is misleading. Some argue that the open group measure is essential to an assessment of financial sustainability, that the closed group measure does not reflect what they describe as the program's pay-as-you-go financing, and that the Social Security and Medicare Trustees' Reports emphasize almost exclusively the open group measure. Other respondents noted that those who object to the closed group measure on the grounds that it does not reflect social insurance financing misunderstand accrual accounting, which seeks to capture economic events, not necessarily financing.

A61. Some said the proposed MD&A standard would be too prescriptive or that it would require too much detail or repeat information that is already in the notes or RSI. Some objected to a

[21] See SI ED, pars. 23-27.

[22] SFFAC 3, par. 33.

standard on social insurance that would require additional MD&A discussion beyond what SFFAS 15 requires or that, in their view, would be unrelated to social insurance.

The Board's Conclusions Regarding MD&A

A62. The Board concludes that the MD&A provisions of the social insurance standard provide flexibility and are not overly prescriptive; nor will they result in redundancy. The Statement incorporates MD&A concepts from SFFAC 3 that currently are not being adequately addressed. Moreover, the Board believes that the long-term nature of social insurance programs requires that management discuss anticipated future demands, events, conditions, and trends as well as those currently existing.

A63. However, the Board did make significant changes to the proposed standard after considering respondents' comments and the views of Board members. First, the Board decided that MD&A should emphasize the open group measure rather than the closed group measure.

A64. In addition, the Board decided to require a table or other singular presentation of key measures in MD&A rather than make it optional, as proposed in the SI ED (see paragraph 25). In the SI ED, the Board had required – and continues to require – a narrative discussion of key measures in MD&A of the government-wide entity and component entities that present a SOSI, as described in paragraphs 23-27, and provided an option whereby the entity could array the key measures in a table or schedule. The Board decided to require a table or other singular presentation because it will significantly enhance the presentation by helping users grasp the relationship between social insurance amounts and other costs, assets and liabilities, budget deficits, and sustainability projections, and therefore the table or other singular presentation should not be optional.

A65. In addition, a table or other singular presentation will relate the basic financial statements to each other. The basic financial statements in the federal reporting model do not all "articulate" with one another. Amounts reported on the balance sheet or statement of net cost, for example, do not tie directly to the present values of the cash flows over the next 75 years that are presented in the SOSI and now the SCSIA, which are also basic statements. A table or other singular presentation will bring all of the pieces of the unique federal reporting model together in a single place. To make this function of the table or other singular presentation explicit, the Board changed the wording of the standard (see paragraph 24) so that the preparer is directed to certain basic financial statements to obtain the key measures.

A66. Lastly, the Board decided not to require the discussion and the table or other singular presentation to be in the section of the MD&A devoted to financial statement analysis. The Board had designated the financial statement analysis section of MD&A, which is one of the sections required by SFFAS 15, because the key measures to be discussed come from the financial statements. Instead, the Board decided to allow it to be wherever in MD&A the preparer thinks will be effective, as long as the specified information is presented together. However, the Board believes that the information should be presented in a single section of MD&A, and that the preparer is best positioned to decide where in MD&A the presentation will be the most effective.

What the Exposure Draft Proposed Regarding the Statement of Net Cost

A67. The proposed standard did not affect the statements of net cost of social insurance entities and the government-wide entity. Some argued that the change in the social insurance closed group measure or other net present value during the reporting period is an economic cost. The economic cost of social insurance programs has been debated by the Board over the years. Some current Board members believed that the change in the closed group measure is an economic cost and were concerned that it is not highlighted on the statement of net cost in the SI ED's compromise proposal.

A68. These members noted that SFFAC 5 defines expense as an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.[23] SFFAC 5 defines liabilities as a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[24] A present obligation requires a past transaction or other event.[25] These members believed that a past transaction or other event occurs when social insurance participants work in covered employment and pay payroll taxes, that an economic cost is being incurred.

A69. Some members noted that accrual accounting has a universal definition: expenses are recognized when incurred. They believed that only through accrual accounting can cost or financial position of an entity be measured, which is why generally accepted accounting principles primarily require accrual accounting. They believe the current focus on cash flow – or on "pay-as-you-go" financing with payroll taxes matched against current benefit payments – is misleading. They believe that payroll taxes received from those currently working in covered employment should be matched not against benefits payments to current retirees but against the economic cost being incurred, in order for accrual accounting to provide a decision-useful additional perspective.

[23] SFFAC 5, par. 53.

[24] SFFAC 5, par. 39.

[25] SFFAC 5, par. 42.

A70. As is discussed above and in the *Preliminary Views* document, Board members, respondents to the *Preliminary Views* document, and, historically, all groups who considered the question have disagreed over the past transaction or event that creates a liability and expense for social insurance programs.

A71. Those FASAB members who were concerned that the economic cost of social insurance is not being highlighted note that FASAB expectations regarding objectives of federal financial reporting in general and social insurance in particular are most clearly set forth in SFFAC 1, *Objectives*. The FASAB's *Strategic Directions* report, issued November 2006, focused on the objectives in SFFAC 1, and established Objective 2, "Operating Performance," and Objective 3, "Stewardship," as FASAB's most important focus. With respect to social insurance, these members note especially sub-objectives 2A, 2B, and 3A regarding the need for information about costs.

A72. These three sub-objectives speak most clearly about financial statements showing costs associated with a specific period and the impact these costs have on an entity's financial position.

A73. Other FASAB Objectives speak about financial statements showing other elements of financial position. The members who are concerned about economic costs believed that SOSI and the new SCSIA adequately satisfy SFFAC 1, *Objectives*, Objective 3B, "Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due." These statements would also contribute to meeting Objective 3C, "Whether government operations have contributed to the nation's current and future well being."

A74. In addition, these members noted that information from the SOSI, if combined with other financial statement information, could help meet Objective 3A, which relates to changes in the government's financial position. Moreover, they believed that the proposed SCSIA, which all members support, will help meet Objective 3A.

A75. However, these members believed that the proposed standard can be criticized for failing to address Objective 2A and 2B, noted above, unless something is reported on the operating statement. For the SI ED, they suggested adding a line item to the statement of net cost to show the change in the social insurance commitment during the period in close proximity to other costs, an approach similar to the new line item that was proposed in the SI ED for the balance sheet.

A76. Other members disagreed that the change in the social insurance commitment should be on the statement of net cost. They believed that cost should represent the goods and services provided during the period. They argued that the change in social insurance, although meaningful, is not a good or service provided, and should not be associated with such costs.

They argued that presenting the change in the social insurance commitment on the statement of net cost would be misleading, that the SOSI amounts are purporting to represent something entirely different from what is on the balance sheet and statement of net cost, and that people expect customary elements on the operating statement for which SOSI amounts are too uncertain.

A77. They noted that the Board made the SOSI a basic statement and proposed that the SCSIA be a basic statement, and that the SOSI and SCSIA are to be presented in close proximity to the balance sheet and operating statement. They believed that that approach is appropriate. For them, the change in the social insurance commitment during the reporting period should be presented apart from the costs of the period and clearly labeled as, for example, "social insurance exposures." They concluded that associating the change with period costs is inappropriate because it does not represent the complete change in the government's financial condition, and that proposed fiscal sustainability reporting, which is now required pursuant to SFFAS 36, provides context and focuses on the government's financial condition.

A78. The SI ED did not require that the change in the closed group measure be recognized as an operating cost of the government on the statement of net cost and the statement of changes in net position. The Board decided to continue the SFFAS 17 approach with respect to expense recognition for social insurance. However, the Board did ask respondents to comment on the issue raised by members regarding the statement of net cost.

Respondents' Comments Regarding the Statement of Net Cost

A79. The respondents overwhelmingly favored the Board's decision not to include a line item for the change during the period in the closed group measure on the statement of net cost. Many of these respondents asserted that they agreed with the position that the change in this measure is not a period cost, and that position is consistent with the view that the closed group measure should not be presented on the balance sheet.

The Board's Conclusions Regarding the Statement of Net Cost

A80. The Board concludes that there is substantial support in the community for the majority position not to include a new line item on the statement of net cost regarding the statement of net cost as presented in the SI ED.

What the Exposure Draft Proposed Regarding Note Disclosure

A81. The SI ED required note disclosure of an accrued benefit obligation. The objective of the disclosure was to provide information for the many users who are interested in knowing what such an amount would be and in evaluating the obligation in this way. An accrued benefit obligation is a measure of the present value of future benefits scheduled to be paid to or on behalf of current participants based on past transactions or events as of the valuation date. For example, for Social Security and Medicare Hospital Insurance (Part A), past work in covered employment; or Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in force. Because it is based on past events, the accrued benefit obligation applies only to current participants in the programs as of the valuation date.

A82. Several methods for calculating an accrued benefit obligation were acceptable.[26] For example, the Social Security Administration provides, through its Office of the Actuary, an accrued benefit obligation for Social Security in a periodically updated Actuarial Note.[27]

A83. Other approaches for calculating an accrued benefit obligation were acceptable. For example, the Primary View in the FASAB's *Preliminary View: Accounting for Social Insurance, Revised*, provided methodology for calculating a liability amount for social insurance programs.

A84. The SI ED stated that the accrued benefit obligation would give interested users a generally understood frame of reference. The accrued benefit obligation is intended to provide a perspective on social insurance programs from the point of view of a deferred benefit or an insurance obligation for those users who value such information. It is equivalent to the measure that the Board members who then held the Primary View believed should be recognized as a liability. The amount thus provided can be compared to the other measures and provide a full array of information. This number is not currently available in federal financial reports.

Respondents' Comments Regarding Note Disclosure

A85. Respondents were nearly evenly dividing regarding the note disclosure. Some said the accrued benefit obligation did not reflect the realities of the program; they argue that it represents a termination valuation and would not be meaningful for social insurance. Some respondents asserted that it would require yet another number and this constitutes "information overload." They and/or others objected to the use of the term "obligation" because they believe it implies the government has an obligation to participants, and they do not think there is any more of an obligation to social insurance participants than to other types of entitlement programs, such as those funded entirely by annual appropriations."

[26] See http://www.ssa.gov/OACT/NOTES/actnote.html.

[27] Actuarial Note: Unfunded Obligation and Transition Cost for OASDI.

A86. Those supporting the disclosure of the accrued benefit obligation mentioned several rationales. Some noted that comprehensive financial reporting requires the accrued benefit obligation perspective, which they say is the only measure of financial status of social insurance programs that can be thought of as a liability because it only involves past transactions and events. They say the accrued benefit obligation provides valuable information to the public about programs upon which participants depend for retirement income and benefits. Another respondent felt that the disclosure would help the reader relate social insurance obligations to federal employee pensions and other retirement benefits. Others felt that the "due and payable" liability measure was simply not based on the proper accounting theory and concepts.

The Board's Conclusions Regarding Note Disclosure

A87. The Board believes that the accrued benefit obligation would give interested readers a generally understood frame of reference and another perspective on social insurance programs. However, the Board decided not to require it in this standard. The Board is persuaded that, given that several measures of the social insurance obligation are already reported in the financial statements, disclosing another number would likely be overwhelming or confusing, rather than enhancing the reader's understanding of the government's social insurance obligations. In addition, the Board is persuaded that, although the SSA provides the amount for Social Security, the accrued benefit obligation is not calculated for Medicare, and there was significant reluctance among members to apply the concept to Medicare or to develop it further for that purpose.

What the Exposure Draft Proposed regarding Sensitivity Analysis

A88. The SI ED proposed to amend the SFFAS 17 sensitivity analysis provisions to allow the preparer more flexibility. The objective of sensitivity analysis is to illustrate how much an estimate or projection would change if the assumptions, data, methodologies, or other inputs change. The Board believes that the SFFAS 17 requirements result in too much narrative and graphs and not enough easy-to-use information.

A89. Although they call for illustrations of the sensitivity of projections and present values,[28] the SFFAS 17 requirements for sensitivity analysis have led preparers to focus on projections that usually are depicted graphically rather than on present values. The latter have increased in importance since the Board elevated the statement of social insurance to a

[28] SFFAS 17, par. 27(4)(a).

basic financial statement in SFFAS 26.[29] The result has been a daunting array of narrative, charts, and graphs. The standard also simplifies the social insurance presentations by eliminating the SFFAS 17 requirement for nominal dollar projections. The projections now will be as percentages of the GDP and taxable payroll.

A90. The Board sought to make the analysis more concise and therefore communicate better with users. The SI ED proposal focused analysis on the sensitivity of the open and closed group measures presented in the basic financial statements –specifically, on the balance sheet, where the closed group measure would have been presented; on the statement of social insurance, where both the closed and open group measures will be presented; and on the proposed new statement of changes in the social insurance amounts, where the closed group measure would have been presented.[30]

A91. Thus, the SI ED proposal was intended to reduce the volume of sensitivity analysis information while increasing its usefulness. It provided flexibility for preparers to develop their own sensitivity analysis and decide what is appropriate based on trends, the utility of the information to the users and policy-makers, and the relative burden of producing it. Entities could continue to vary key assumptions or pursue other methods, including stochastic modeling.

Respondents' Comments Regarding Sensitivity Analysis

A92. A majority of respondents agreed with the proposed new flexibility. However, some respondents asserted that sensitivity analysis should continue to include estimates of the effects of changes in individual assumptions. In addition, they or others noted that stochastic modeling, which the proposal encouraged, is useful for illustrating uncertainty but was fundamentally different than illustrating the sensitivity of individual assumptions. They discouraged suggesting that the preparer may consider stochastic analysis since it is a science still under development and including it would require much explanatory detail and complexity. Some respondents mentioned that sensitivity analysis should be undertaken only for the open group measure.

[29] *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, November 1, 2004.

[30] For the final standard, this is now the open group measure.

The Board's Conclusions Regarding Sensitivity Analysis

A93. The Board continues to believe that a flexible yet focused approach to sensitivity analysis is best. Thus, the standard continues to require sensitivity analysis of the closed and open group measures that in the preparer's best judgment effectively communicates with the users. Thus, the preparer would consider future trends, the utility of the information to the users and policy-makers, and the relative burden on its resources.

A94. The Board decided not to include a statement that preparers may consider stochastic modeling. The Board weighed the cautionary responses in that regard from the American Academy of Actuaries and the Chief Actuary of the Social Security Administration. The Board believes that the flexibility of the standard will allow the preparers and their advisors to illustrate sensitivity of the open and closed group measures by varying individual assumptions or by other means they believe are meaningful and comprehensible.

Valuation Date

A95. The SI ED proposed to amend SFFAS 17's valuation date provision by requiring that projections be adjusted, if feasible, after the valuation date but prior to the end of the fiscal year, if changes in policy or other major factors materially affect it. This provision is identical to that in the Board's recently issued SFFAS 36. It addresses the need for projections to reflect recent data.

A96. One respondent found the term "if feasible" problematic. The respondent asserted that, if information comes to the attention of the preparer that impacts the projection after the valuation date, the feasibility of using it to adjust the projection should not be a consideration. The respondent also thought it would be a problem from an audit perspective.

A97. The Board concludes that the additional requirement to consider changes in major factors occurring after the valuation date will enhance the usefulness of social insurance information. In addition, feasibility is a consideration in the context of federal financial reporting. The benefit of financial information must be weighed against its cost.

Board Approval

A98. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB office.

Appendix B: Illustrative Table of Key Measures

Table of Key Measures			
	billions of dollars		
	2008	2007	2006
Costs			
Net costs	($3,671)	($2,903)	($2,890)
Total taxes and other revenues	2,661	2,627	2,441
Net operating cost	(1,010)	(276)	(449)
Net Position			
Assets	$1,975	$1,581	$1,497
Less: liabilities, comprising			
Federal debt held by the public	5,836	5,078	4,868
Federal employee & veterans benefits	5,319	4,769	4,679
Other liabilities	1,023	940	866
Total liabilities	12,178	10,787	10, 413
Net position (assets net of liabilities)	($10,203)	($9,206)	($8,916)
Social Insurance Commitments			
Net present value (NPV) of future cash flows for all participants over the next 75 years (open group), end of fiscal year	($42,970)	($40,948)	($38,851)
NPV of future cash flow for all participants over the next 75 years (open group), beginning of fiscal year	(40,948)	($38,851)	($35,689)
Change in NPV	(2,022)	(2,097)	(3,162)
Budget Results			
Unified budget deficit	($455)	($163)	($248)
Spending in Excess of Receipts			
Spending in excess of receipts (see long-term projections statement)	($XX,XXX)	($XX,XXX)	($XX,XXX)

Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI

United States Government
Statement of Social Insurance

(In billions of dollars)	2008	2007	2006	2005	2004
	********UNAUDITED***********				
Federal Old-Age, Survivors, and Disability Insurance (Social Security):					
Contributions and earmarked taxes from:					
Participants who have attained age 62	$ 542	$ 477	$ 533	$ 464	$ 411
Participants ages 15-61	18,249	17,515	16,568	15,290	14,388
Future participants (under age 15 and births during period)	17,566	16,121	15,006	13,696	12,900
All current and future participants	36,357	34,113	32,107	29,450	27,699
Expenditures for scheduled future benefits for:					
Participants who have attained age 62	(6,958)	(6,329)	(5,866)	(5,395)	(4,933)
Participants ages 15-61	(29,091)	(27,928)	(26,211)	(23,942)	(22,418)
Future participants (under age 15 and births during period)	(6,933)	(6,619)	(6,480)	(5,816)	(5,578)
All current and future participants	(42,911)	(40,876)	(38,557)	(35,153)	(32,929)
Net present value (NPV) of future revenue less future expenditures (open group measure)	$ (6,555)	$ (6,763)	$ (6,450)	$ (5,703)	$ (5,230)

Federal Hospital Insurance (Medicare Part A):	2008	2007	2006	2005	2004
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 202	$ 178	$ 192	$ 162	$ 148
Participants who have not attained eligibility age	6,320	5,975	5,685	5,064	4,820
Future participants	5,361	4,870	4,767	4,209	4,009
All current and future participants	11,883	11,023	10,644	9,435	8,977
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(2,747)	(2,558)	(2,397)	(2,179)	(2,168)
Participants who have not attained eligibility age	(17,365)	(15,639)	(15,633)	(12,668)	(12,054)
Future participants	(4,506)	(5,118)	(3,904)	(3,417)	(3,246)
All current and future participants	(24,619)	(23,315)	(21,934)	(18,264)	(17,468)
NPV of future revenue less future expenditures (open group measure)	$(12,736)	$(12,292)	$(11,290)	$ (8,829)	$ (8,491)
Federal Hospital Insurance (Medicare Part B):	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 461	$ 433	$ 409	$ 363	$ 332
Participants who have not attained eligibility age	3,859	3,184	3,167	2,900	2,665
Future participants	1,158	1,172	906	924	891
All current and future participants	5,478	4,789	4,482	4,187	3,888
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(1,986)	(1,834)	(1,773)	(1,622)	(1,475)
Participants who have not attained eligibility age	(14,949)	(12,130)	(12,433)	(11,541)	(10,577)
Future participants	(4,262)	(4,257)	(3,407)	(3,408)	(3,277)
All current and future participants	(21,197)	(18,221)	(17,613)	(16,571)	(15,329)
NPV of future revenue less future expenditures (open group measure)	$(15,719)	$(13,432)	$(13,131)	$(12,384)	$(11,441)

Federal Hospital Insurance (Medicare Part D):	2008	2007	2006	2005	2004
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 123	$ 167	$ 173	$ 185	$ 176
Participants who have not attained eligibility age	1,380	1,627	1,700	1,790	1,857
Future participants	604	611	492	572	618
All current and future participants	2,107	2,405	2,365	2,547	2,651
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(581)	(794)	(792)	(880)	(773)
Participants who have not attained eligibility age	(6,527)	(7,273)	(7,338)	(7,913)	(7,566)
Future participants	(2,856)	(2,699)	(2,121)	(2,440)	(2,431)
All current and future participants	(9,964)	(10,766)	(10,251)	(11,233)	(10,770)
NPV of future revenue less future expenditures (open group measure)	$ (7,857)	$ (8,361)	$ (7,886)	$ (8,686)	$ (8,119)
Railroad Retirement:	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 5	$ 5	$ 5	$ 4	$ 4
Participants who have not attained eligibility age	43	41	40	37	37
Future participants	54	54	56	41	39
All current and future participants	102	100	101	82	80
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(97)	(93)	(92)	(84)	(81)
Participants who have not attained eligibility age	(88)	(86)	(84)	(73)	(72)
Future participants	(26)	(26)	(25)	(16)	(14)
All current and future participants	(212)	(205)	(201)	(173)	(167)
NPV of future revenue less future expenditures (open group measure)	$ (109)	$ (105)	$ (100)	$ (91)	$ (87)
Black Lung (Part C):	**2008**	**2007**	**2006**	**2005**	**2004**
NPV of future revenue less future expenditures (open group measure)	$ 5	$ 5	$ 4	$ 5	$ 4
Total NPV of future revenue less future expenditures (open group measure)	$(42,970)	$(40,948)	$(38,853)	$(35,688)	$(33,364)

Social Insurance Summary	2008	2007	2006	2005	2004
Participants who have attained eligibility age:					
Revenue (e.g., contributions and earmarked taxes)	$ 1,333	$ 1,260	$ 1,312	$ 1,178	$ 1,071
Expenditures for scheduled future benefits	(12,369)	(11,608)	(10,920)	(10,160)	(9,430)
Present value of future revenue less future expenditures	(11,036)	(10,348)	(9,608)	(8,982)	(8,359)
Participants who have attained age 15 up to eligibility age:					
Revenue (e.g., contributions and earmarked taxes)	29,851	28,342	27,160	25,081	23,767
Expenditures for scheduled future benefits	(67,950)	(63,056)	(61,699)	(56,137)	(52,687)
Present value of future revenue less future expenditures	(38,099)	(34,714)	(34,539)	(31,056)	(28,920)
Closed group -- Total present value of future revenue less future expenditures for current participants	(49,135)	(45,062)	(44,147)	(40,038)	(37,279)
Future participants (those under age 15, and those to be born and to immigrate during period):					
Revenue (e.g., contributions and earmarked taxes)	24,743	22,828	21,227	19,442	18,457
Expenditures for scheduled future benefits	(18,578)	(18,714)	(15,933)	(15,092)	(14,542)
Present value of future revenue less future expenditures	6,165	4,114	5,294	4,350	3,915
Open group -- Total present value of future revenue less future expenditures for current and future participants	$(42,970)	$(40,948)	$(38,853)	$(35,688)	$(33,364)

Statement of Social Insurance, Part II, Component Entity Illustrative Social Security Administration			********UNAUDITED***********		
(In billions of dollars)	**2008**	**2007**	**2006**	**2005**	**2004**
Federal Old-Age, Survivors, and Disability Insurance (Social Security):					
Participants who have attained eligibility age:					
Contributions and earmarked taxes	$ 542	$ 477	$ 533	$ 464	$ 411
Expenditures for scheduled future benefits	(6,958)	(6,329)	(5,866)	(5,395)	(4,933)
Present value of future expenditures in excess of future revenue	(6,416)	(5,852)	(5,333)	(4,931)	(4,522)
Participants who have attained age 15 up to eligibility age:					
Contributions and earmarked taxes	18,249	17,515	16,568	15,290	14,388
Expenditures for scheduled future benefits	(29,021)	(27,928)	(26,211)	(23,942)	(22,418)
Present value of future revenue less future expenditures	(10,772)	(10,413)	(9,643)	(8,652)	(8,030)
Net present value of future revenue less future expenditures for current participants (closed group measure)	(17,218)	(16,265)	(14,976)	(13,583)	(12,552)
Less: Treasury securities and assets held by the programs	2,238	2,048	1,859	1,687	1,531
Closed group unfunded obligation	$(14,980)	$(14,217)	$(13,117)	$(11,896)	$(11,021)
Future participants (those under age 15 and to be born and to immigrate during period):					
Contributions and earmarked taxes	$ 17,566	$ 16,121	$ 15,006	$ 13,696	$ 12,900
Expenditures for scheduled future benefits	(6,933)	(6,619)	(6,480)	(5,816)	(5,578)
Present value of future revenue less future expenditures	10,633	9,502	8,526	7,880	7,322
Net present value of future revenue less future expenditures for current and future participants (open group measure)	(6,555)	(6,763)	(6,450)	(5,703)	(5,230)
Less: Treasury securities and assets held by the programs	2,238	2,048	1,859	1,687	1,531
Open group unfunded obligation	$(4,317)	$(4,715)	$(4,591)	$(4,016)	$(3,699)

Appendix D: Illustrative Statement of Changes in Social Insurance Amounts

The following is an illustrative statement of changes in social insurance amounts.

Illustrative Statement of Changes in Social Insurance Amounts
0pen Group Measure
For the Year Ended September 30, 2008
(in billions of dollars)

	Social Insurance, Open Group Measure				
	Social Security	Medicare HI	Medicare SMI	Other (e.g., Railroad Retirement)	Total
Net present value (NPV) of future revenue less future expenditures for current and future participants (the "open group") over the next 75 years, beginning of the year	$(6,763)	$(12,292)	$(21,793)	$ (100)	$(40,948)
Reasons for changes in the NPV during the year:					
Changes in valuation period	XXX	XXX	XXX	XXX	XXX
Changes in demographic data and assumptions[1]	XXX	XXX	XXX	XXX	XXX
Changes in economic data and assumptions[2]	XXX	XXX	XXX	XXX	XXX
Changes in law or policy[3]	XXX	XXX	XXX	XXX	XXX
Changes in methodology and programmatic data[4]	XXX	XXX	XXX	XXX	XXX
Changes in Medicare healthcare and other healthcare assumptions	XXX	XXX	XXX	XXX	XXX
Other changes	XXX	XXX	XXX	XXX	XXX
Net change in open group measure	208	(443)	(1,783)	(4)	(2,022)
Open group measure, end of year	$(6,555)	$(12,735)	$(23,576)	$(104)	$(42,970)

The following note examples are adapted from the Social Security Trustees' Report. The explanations of the changes will depend on the social insurance program in question.

1. Changes in demographic assumptions affect the open group measure. Final mortality data for 2008 result in slightly lower starting death rates and faster near-term declines in death rates than in last year's report. Also, slightly faster rates of decline in death rates are assumed ultimately for ages 15-64 in this year's report. These changes in ultimate rates are based on the continuing strong declines in mortality recently experienced by men at these

ages and a belief that the lower rates of decline experienced by women since 1982 will not continue in the future. All of the mortality changes result in a decrease (worsening) in the open group measure of about $200 billion.

2. Ultimate economic assumptions are unchanged from last year's report. Changes in starting values for the economic assumptions and in the near-term transition to the ultimate economic assumptions have a negligible effect on the social insurance closed group measure.

3. There were no legislative changes since the last report that are projected to have a significant effect on the long-range OASDI actuarial balance.

4. Several methodological improvements and updates of program-specific data are included in the 2008 measures. These changes to programmatic data and methods result in a combined increase (improvement) in the open group measure of about $171 billion.

Appendix E: List of Abbreviations

CFR	Consolidated financial report
CFS	Consolidated financial statements
CPI	Consumer Price Index
DI	Disability Insurance (Social Security)
DOL	U.S. Department of Labor
ED	exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
HHS	Department of Health and Human Services
IPSASB	International Public Sector Accounting Standards Board
MA	Medicare Advantage
MD&A	Management's Discussion and Analysis
Medicare HI	Hospital Insurance (Medicare)
Medicare SMI	Supplementary Medical Insurance (Medicare)
OASDI	Old-Age, Survivors, and Disability Insurance (Social Security)
OASI	Old-Age and Survivors Insurance (Social Security)

OMB	Office of Management and Budget
RRB	Railroad Retirement Board
RSI	Required supplementary information
SCNP	Statement of Changes in Net Position
SCSIA	Statement of Changes in Social Insurance Amounts
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SI ED	Social Insurance Exposure Draft dated November 2008
SMI	Supplementary Medical Insurance
SNC	Statement of Net Cost
SOSI	Statement of Social Insurance
SSA	Social Security Administration
UI	Unemployment Insurance
UTF	Unemployment Trust Fund

Statement of Federal Financial Accounting Standards 38: Accounting for Federal Oil and Gas Resources

Status

Issued	April 13, 2010
Effective Date	For periods beginning after September 30, 2012
Affects	None.
Affected by	SFFAS 41, par. 2, amended the effective date in pars. 5 and 30.

Summary

This standard requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves to be reported in a schedule of estimated federal oil and gas petroleum royalties. In addition, this standard requires the value of estimated petroleum royalty revenue designated for others to be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented in required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity.

This Statement is effective as RSI for periods beginning after September 30, 2012. Earlier implementation is encouraged. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. This Statement will remain in effect until such time a determination is made.

Table of Contents

Introduction

Purpose

1. Statements of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*; 8, *Supplementary Stewardship Reporting*; and 29, *Heritage Assets and Stewardship Land*, establish standards related to federal lands, but specifically exclude natural resources from the scope of those standards. Extensive **federal oil and gas resources**[1] exist on public lands throughout the country and on the **Outer Continental Shelf** (OCS). Currently, federal financial reporting does not provide information about the quantity or value of these assets.

2. The Board believes that federal oil and gas resources represent federal assets and accounting for and reporting information about these assets would enhance accountability for and stewardship over assets of the federal government.

3. This Statement provides for a more complete accounting for oil and gas resources available to the federal government. Accounting for the federal government's **royalty** share of **proved reserves** as an asset and reporting information on that asset as required supplementary information (RSI) would provide transparency regarding the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives.

Materiality

4. 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.

[1] Terms defined in Appendix D: Technical Terms or the Glossary are shown in **bold-face** the first time they appear.

Effective Date

5. The standards are effective as RSI for periods beginning after September 30, 2012. Earlier implementation is encouraged.

6. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement **recognition** or note disclosure. This Statement will remain in effect until such time a determination is made.

Standards

Scope

7. This Statement applies to federal entities that report information about federal oil and gas resources in general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board* (FASB).

8. This Statement articulates a general principle that should guide preparers of general purpose federal financial reports in accounting for federal oil and gas resources.

9. Federal lands contain a variety of natural resources other than oil and gas proved reserves that are not specifically addressed by this Statement. This Statement does not require or preclude entities from reporting information about other types of federally-owned natural resources; however, this Statement should be considered in conjunction with SFFAS 7, *Accounting for Revenue and Other Financing Sources,* when applying SFFAS 34 to other types of federally-owned natural resources.[2]

[2] SFFAS 7, par. 45, requires, in instances where there are virtually no costs incurred in earning exchange revenue, that federal entities recognize the revenue as a financing source on the statement of changes in net position, rather than the statement of net cost.

Definitions

10. Definitions in paragraphs 11 and 12 are presented first in the accounting standards because they are new technical terms not previously defined in federal accounting standards.

11. **Federal oil and gas resources**: **Oil** and **gas** resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

12. **Regional estimated petroleum royalties**: Regional **estimated petroleum royalties** means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources in each **region**.

Accounting and Reporting of Federal Oil and Gas Resources by Component Entities

Schedule of Estimated Federal Oil and Gas Petroleum Royalties

13. Extensive federal oil and gas resources exist on public lands throughout the country and on the Outer Continental Shelf (OCS). These resources will provide economic benefits to the federal government through revenue from leasing activities and the collection of royalties on production. The federal government controls access to these resources.

14. Federal oil and gas resources are made up of two primary components – reserves and **undiscovered resources**. Reserves can be further defined as either proved or unproved while undiscovered resources can be further defined as either recoverable or non-recoverable. See *Figure 1 – Components of Federal Oil and Gas Resources* in the basis for conclusions for an illustration of the universe of federal oil and gas resources and a further breakdown of its components.

15. The value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves should be reported in a schedule of estimated federal oil and gas petroleum royalties by the component entity that is responsible for collecting royalties. This schedule should be presented in RSI as part of a discussion of all significant federal oil and gas resources under management by the entity.

16. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities. In an environment heavily affected by

changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect these changing conditions.

17. The estimates that are developed should approximate the **present value** of future federal royalty receipts on proved reserves known to exist as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible.

18. Discount rates as of the reporting date for present value measurements of federal oil and gas resources should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted.

19. The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. While the entity's own assumptions about future cash flows may be used, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and Product Accounts. If the entity's own assumptions do not reflect data that are consistent with sources independent of the reporting entity, an explanation of why the entity's own assumptions are preferred should be provided.

20. The value of the federal government's estimated petroleum royalties should be computed based on the calculation of federal oil and gas proved reserves on a regional basis. For purposes of these standards, the regions used in determining and reporting regional amounts or factors should be collaboratively developed by all the component entities involved in federal oil and gas resource activities. Regions used in calculating regional estimated petroleum royalties and in applying these standards should be consistent and aligned with regions used internally by the component entities in administering federal oil and gas resource activities.

21. The estimates of future federal royalty receipts on proved reserves known to exist as of the reporting date should be divided further by commodity and type (e.g., wet gas, **dry gas**, oil and **lease condensate**, onshore, offshore, etc.) and calculated separately if material differences would otherwise result. Each of the individual calculations should be reported separately and summed together to arrive at the federal government's total estimated petroleum royalties.

22. The preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves using a risk-free discount rate as described in paragraph 17; however, alternative methods

for measuring **fair value** or current price may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 17 through 19.[3]

23. Once established, the estimation methodology should be consistently followed and explained in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be explained.

Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others

24. The majority of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves are distributed to state governments, other federal agencies, and the general fund of the U.S. Treasury in accordance with legislated allocation formulas. The legislated allocation formulas constitute a present obligation[4] of the component entity that is responsible for collecting royalties to provide assets to another entity, and the underlying legislation identifies the conditions under which these distributions will be made.

25. The value of estimated federal oil and gas petroleum royalty revenue designated for others should be reported in a schedule of estimated petroleum royalties to be distributed to others by the component entity that is responsible for collecting royalties. This schedule should be presented in RSI by type of entity as part of a discussion of all significant federal oil and gas resources under management by the entity.

26. The value of the revenue to be distributed to others should be estimated based on the portion of the royalty share of the federal proved oil and gas reserves designated to be distributed to others. For example, the average annual share of the revenue distributed to

[3] Calculating the present value of future federal royalty receipts employs the use of a number of estimates including estimating when the proved reserves will be produced over time, future oil and gas prices, and the possibility and extent of royalty-free production. Unforeseen circumstances may result in situations where it is not possible for the entity to reasonably estimate the present value of future federal royalty receipts. In these situations, it may be possible to estimate current price. Current price, sometimes referred to as a "fresh-start" or "remeasured" price, is a general term for various attributes measured as of a financial statement date subsequent to the period of initial recognition, including replacement price, market price, and settlement price.

[4] The term obligation is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

others over the preceding twelve (12) months may be an acceptable basis for estimating petroleum royalties to be distributed. Other methodologies may also be acceptable.

Annual Valuation of Estimated Petroleum Royalties and Petroleum Royalties to be Distributed to Others

27. The estimated petroleum royalties asset value and petroleum royalties to be distributed to others should be valued at the end of each fiscal year.

Component Entity Reporting Requirements

28. The component entity responsible for collecting royalties should provide the following as narrative to the schedules presented as RSI:

    a. A concise statement explaining how the management of federal oil and gas resources is important to the overall mission of the entity.

    b. A brief description of the entity's stewardship policies for federal oil and gas resources. The stewardship policies for federal oil and gas resources should describe the guiding principles established to: assess the oil and gas resource areas; offer those resources to interested developers; sell and assign **leases** to winning bidders; administer the leases; collect bonuses, **rents**, royalties, and **royalty-in-kind**; and distribute the collections consistent with statutory requirements, prohibitions, and limitations governing the entity.

    c. A narrative describing future royalty rights identified for sale, if applicable. The narrative should provide the value of the rights identified for future sale, the location of the **field**(s) involved in the future sale, and the best estimate of when the rights would be sold. The calculated value reported for future royalty rights identified for sale should be based on the specific field to be sold and consistent with the valuation requirements of paragraph 22.

    d. A narrative describing and a display showing revenue reported by category for the reporting period should be presented for offshore and onshore revenues for the following categories: royalty revenue for oil and gas; rent revenue; **bonus bid** revenue for leases; and total revenue from all the above categories.

    e. A narrative describing and a display showing:

        (1) the quantity of oil and gas proved reserves at the end of the reporting period;

(2) the average of the Regional Average **First Purchase Prices** for oil and the average of the Regional Average **Wellhead Prices** for gas for the reporting period; and,

(3) the average **royalty rate** for oil and gas for the reporting period.

f. A narrative describing the estimation methodology used to calculate the value of the federal government's estimated petroleum royalties. At a minimum, the narrative explanation should include a "plain English" explanation of the measurement method (e.g., present value), the significant assumptions incorporated into the estimate (e.g., discount rates used to calculate present value, production decline curve, portion of proved reserves under federal lands, future oil and gas prices, inflation rates, etc), and any significant changes in the estimation methodology, including the underlying assumptions, from the prior year. As required by paragraph 23, the nature and reason for any changes, as well as the effect of the changes, should be explained.

g. A reference to the source reports used to calculate the value of the federal government's estimated petroleum royalties.

h. A narrative describing and a display showing the **sales volume**, the **sales value**, the royalty revenue, and the **estimated value for royalty relief** produced from federal oil and gas resources for the reporting period. To the extent that regional information is available and would contribute to understanding, the information for each region should be provided.

i. A narrative describing other significant federal oil and gas resources under management by the entity that are not addressed by this Statement because they are not currently under lease (e.g., coastal plain of the Arctic National Wildlife Refuge). The narrative should be sufficient to enable the financial statement reader to gain an understanding of the full extent of federal oil and gas resources under management by the entity.

Consolidated Financial Report (CFR) of the United States Government Reporting Requirements

29. The governmentwide entity should provide the following information related to federal oil and gas resources in RSI as part of a discussion of all significant federal oil and gas resources under management by the federal government:

a. A concise statement explaining the nature and valuation of federal oil and gas resources.

b. A narrative describing and a display showing:

(1) the quantity of oil and gas proved reserves at the end of the reporting period;

(2) the average of the Regional Average First Purchase Prices for oil and the average of the Regional Average First Wellhead Prices for gas for the reporting period;

(3) the average royalty rate for oil and gas for the reporting period;

(4) the asset value for oil and gas by the commodities and types identified for use in calculating the federal government's total estimated petroleum royalties for the reporting period (see paragraph 21); and,

(5) the value of estimated petroleum royalties at the end of the reporting period.

c. A reference to specific agency reports for additional information about federal oil and gas resources.

Effective Date

30. The standards are effective as RSI for periods beginning after September 30, 2012. Earlier implementation is encouraged.

31. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. This Statement will remain in effect until such time a determination is made.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. The project began with the formation of a task force to conduct research. The task force produced a discussion paper in June 2000 entitled *Accounting for the Natural Resources of the Federal Government* (see http://www.fasab.gov/ pdffiles/natresrpt.pdf to access the report). In 2002, the Board resumed active consideration of the issues raised by the task force after a deferral to address other issues.

A2. The Board was interested in determining whether values for federal natural resources, or some surrogate, should be capitalized and reported on the balance sheet. The Board members believed that capitalizing federal natural resources could increase accountability for their management and improve the comprehensiveness, relevance, and consistency of federal financial statements. The Board members agreed to address each type of natural resource (e.g., fluid leasable minerals such as oil and gas, solid leasable minerals such as coal and timber, etc.) in separate phases. Federal oil and gas resources were addressed first because of the literature available in other domains, the extensive historical information on federal lease programs and royalty collections, and the large amount of revenue received in exchange for federal oil and gas resources.

A3. The Board indicated that the pertinent questions were (1) what, if anything, should be recognized as an asset; and, (2) what is the source and reliability of quantity information. They believed the source and the reliability of the information would have a bearing on where information should be reported.

A4. The extractive industries' activities for oil and gas can be divided into two categories—upstream activities (exploration and production activities) and downstream activities (transportation, refining, and marketing activities). Upstream activities can be divided into the following phases:

a. Prospecting[5]

b. Acquisition of mineral rights

c. Exploration

d. Appraisal and evaluation

e. Development

f. Production

A5. Downstream activities take place after the production phase of the upstream activities through to the point of sale and can be divided into the following phases:

a. Supply and trading

b. Shipping

c. Refining

d. Storage and distribution

e. Marketing and retail

A6. The national assessment of federal oil and gas resources performed by the federal government is similar to the prospecting phase of the extractive industries' upstream activities. It is the only activity performed by the federal government that is similar to the extractive industries' activities.

A7. The Board noted that, based on discussions about oil and gas lease activities in the private sector, new models for accounting and reporting on the federal government's oil and gas activities would be needed because the current federal model is incomplete and federal activities are not similar to private sector activities.

[5]Prospecting usually involves researching and analyzing an area's historic geologic data and carrying out topographical, geological, and geophysical studies.

A8. The Board released two exposure drafts (EDs) to solicit comments on its proposed requirements for accounting for federal oil and gas resources. The original ED, *Accounting for Federal Oil and Gas Resources,* was released on May 21, 2007. A revised ED by the same name was released on July 6, 2009. The board considered the comments received on the two EDs and related field testing in reaching its current position.

Accounting for Other Types of Natural Resources

A9. Federal lands contain a variety of natural resources that are not specifically addressed by this Statement, including coal, gold, and silver, as well as timber and grazing rights. Originally, the Board intended to address each category of resources in separate phases as noted in paragraph A2. Although in principle a broader application was desirable to several Board members, the majority believes that the Board has already devoted a substantial amount of time to the oil and gas standard and developing additional guidance for the other types of resources would significantly delay implementation of a broad standard. Therefore, because federal oil and gas resources represent the most significant portion of all federal natural resources, the majority of members felt it was important to begin recognizing them as soon as possible.

A10. Nonetheless, the majority of the members believe that the substance of the standards developed for federal oil and gas resources may serve as a good analogy for other categories of federal natural resources.[6] Therefore, while this Statement does not specifically address other types of federal natural resources, the Board believes that this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 9 to explicitly state that this Statement does not require or preclude entities from reporting information about other types of federally-owned natural resources; however, members believe this Statement should be considered in conjunction with SFFAS 7, *Accounting for Revenue and Other Financing Sources*, when applying SFFAS 34 to other types of federally-owned natural resources.

A11. The Board directed staff to apply the requirements of this Statement to other types of natural resources through the issuance in the future of a technical bulletin.

Fiduciary Oil and Gas Resources

A12. SFFAS 31, *Accounting for Fiduciary Activities*, par. 12, states that “Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending

[6] SFFAS 34, Paragraph 7.

disposition, or held long-term in a fiduciary capacity." Both the original and revised EDs included a paragraph on fiduciary oil and gas resources that required similar reporting for fiduciary proved oil and gas reserves. However, one of the respondents to the revised ED raised a question of whether fiduciaries are required to value non-monetary assets. In addition, the Board discussed whether there are currently any oil and gas reserve activities that would meet the definition of fiduciary activity.[7] Since this Statement requires RSI reporting for federal oil and gas proved reserves and would not trigger reporting under SFFAS 31, the Board is deferring the issue of whether reporting should be required for fiduciary proved oil and gas reserves. No reporting on fiduciary oil and gas resources is required as a result of this Statement. The Board will revisit the issue of reporting on fiduciary oil and gas resources either through the issuance of the technical bulletin mentioned in paragraph A11 or when the Board revisits accounting and reporting for federal oil and gas resources in three years as discussed in paragraph A38.

Overview of Federal Oil and Gas Resources

A13. *Figure 1*, *Components of Federal Oil and Gas Resources*, presented after paragraph A27 identifies the universe of federal oil and gas resources (total resources). Total resources incorporate "original in-place" resources, that is, resources in the earth before human intervention. The components are those used in the industry. Information is available in varying degrees and with varying reliability for each component. The components are first separated into "undiscovered resources" and "reserves." Generally, undiscovered resources are not under lease, while reserves are under lease.

Undiscovered Resources

A14. The first major component of total resources is undiscovered resources. The undiscovered resources component is divided into the following subcomponents:

a. **undiscovered non-recoverable resources**

b. **undiscovered recoverable resources**

(1) **undiscovered conventionally recoverable resources**

(2) **undiscovered economically recoverable resources**.

[7] Members questioned whether the federal government currently assumes any fiduciary responsibility for non-federal oil and gas leases beyond the collection of royalties.

A15. Each component and subcomponent can be further divided between onshore and offshore resources. Onshore resources consist of resources on federal lands. Offshore resources consist of resources on the Outer Continental Shelf (OCS). This division between onshore and offshore resources is important operationally because the source and volume of information varies.

A16. There is no information available on undiscovered non-recoverable resources. These resources are not addressed or included in any type of assessment. Undiscovered non-recoverable resources are referred to as resources that are beyond conventional technologies to be estimated and are not assessed. However, in the realm of "original in-place" resources they may exist.

A17. Information on the two subcomponents of undiscovered recoverable resources is available for offshore oil and gas resources. This information is based on national assessments performed by the Minerals Management Service (MMS) approximately every five years, with updates on a yearly basis for certain geographic locations. The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic **play** analysis approach for resource appraisal. Information on undiscovered conventionally recoverable resources and undiscovered economically recoverable resources is provided in the MMS assessment.

A18. For the onshore portion of undiscovered recoverable resources, the U.S. Geological Survey (USGS) formerly conducted national assessments. The last comprehensive national assessment was completed by the USGS in 1995, and since 2000 the USGS has been re-assessing **basins** of the U.S. that are considered to be priorities for the new assessment rather than assessing all of the basins of the U.S. As each basin is re-assessed, the assessment results are added to the assessment tables, and these new values replace the assessment results from 1995. The USGS assessment provides information on undiscovered conventionally recoverable resources but not on undiscovered economically recoverable resources like the MMS does.

A19. Under existing Federal Accounting Standards Advisory Board (FASAB) accounting standards, there are no requirements to provide or present information about the undiscovered resource components in the financial statements. Information about **technically recoverable resources** was gathered and maintained by the Energy Information Administration (EIA) in the past. However, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is no reliable source for this type of information, federal reporting on onshore and offshore undiscovered recoverable resources is not required.

Reserves

A20. The second major component of total resources is **reserves**. The reserves component is divided into the following subcomponents as follows:

a. **unproved reserves**

(1) **unproved possible reserves**

(2) **unproved probable reserves**

b. **proved reserves**

(1) **proved undeveloped reserves**

(2) **proved developed reserves**

(a)**proved developed non-producing reserves**

(b)**proved developed producing reserves**

A21. Under existing FASAB accounting standards, there are no requirements to provide or present information about the unproved reserves components in the financial statements.

A22. Under the accounting standards proposed in the original ED, information about onshore and offshore unproved reserves would be included in the technically recoverable resources and reported as RSI. However, as noted in par. A19, although information about technically recoverable resources was gathered and maintained by the EIA in the past, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is no reliable source for this type of information, federal reporting on unproved reserves is not required.

A23. Quantitative information in relation to onshore and offshore proved reserves, including new discoveries, production, and **adjustments** is submitted to the EIA by oil and gas well operators once a year. The due date for operators to submit the information is April 15 for activities from the preceding calendar year.

A24. Under existing accounting standards, the bonus bid, rent (collected on the lease until oil and gas production begins), and royalty revenue (collected on production) are accounted for as a custodial activity (i.e., an amount collected for others) by MMS, the collecting entity. The collections and their distribution are reported on MMS's statement of custodial activities. Component entities receiving a distribution and the CFR of the United States government recognize the revenue as a financing source in their respective statement of changes in net position or statement of operations and changes in net position.

A25. In addition to the above existing accounting standards, this Statement requires that the estimated federal royalty share of proved reserves be reported in RSI as estimated petroleum royalties by the component entity that is responsible for collecting royalties. The portion of the estimated petroleum royalty revenue designated to be distributed to others should also be reported in RSI.

A26. This Statement also requires that information on the quantity and consumption of proved reserves, including the sales volume, the sales value, the amount of royalty revenue, and the estimated value for royalty relief be provided as RSI.

A27. On the following page, *Figure 1 – Components of Federal Oil and Gas Resources* provides a summary of the information presented in the preceding paragraphs. The shaded boxes in the figure represent the availability of information as follows:

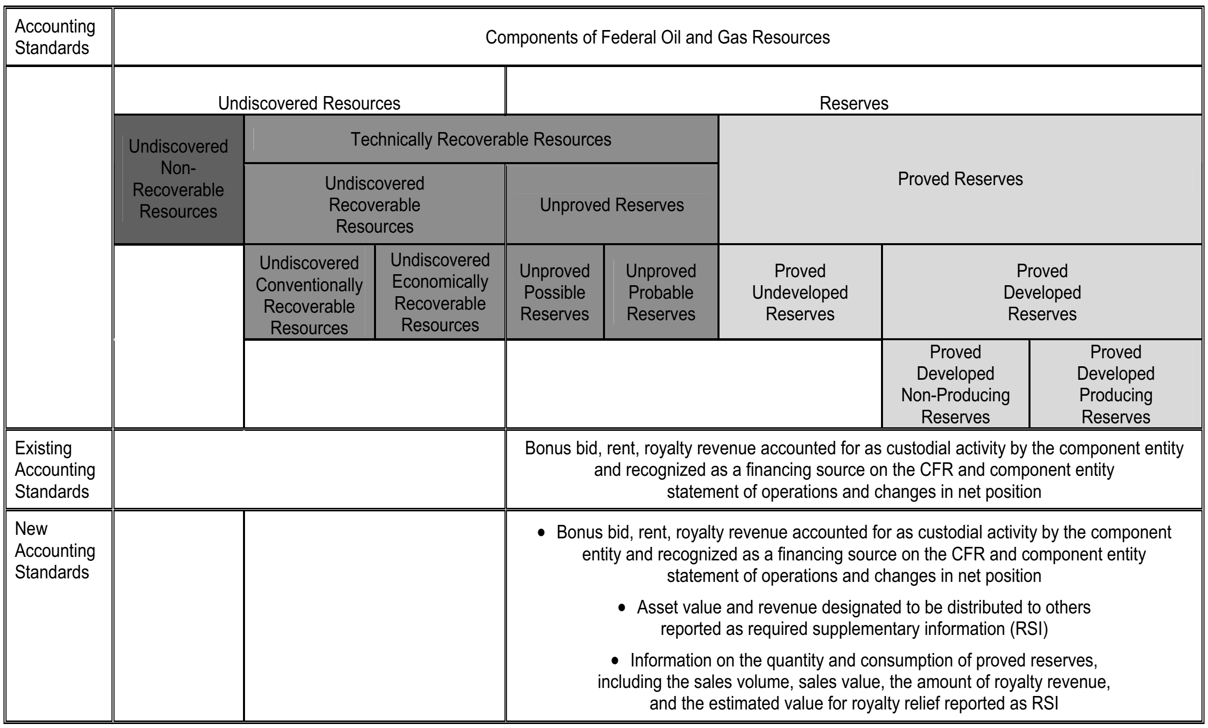
No quantity information available	
Technically recoverable resources quantity information provided by EIA at the national level[8]	
Proved reserves quantity information provided by EIA at the national level[9]	

The terms in Figure 1 are defined in Appendix D: Technical Terms under the subheading Definitions of Resource and Reserve Components and Subcomponents.

[8]Quantity information is currently only published at the national level; segregated information on the quantity of oil and gas resources under federal lands is not available.

[9]See footnote 8.

Figure 1 – Components of Federal Oil and Gas Resources



Conceptual Aspects of Federal Oil and Gas Resources as an Asset for Estimated Petroleum Royalties and a Liability for the Portion of Revenue to be Distributed to Non-Federal Entities

Recognition Criteria

A28. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, states that to be recognized as an element of the financial statements, an item must (a) meet the definition of an element of the financial statements and (b) be measurable. The term measurable means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.[10]

A29. Measurement may require the use of estimates and approximations as well as an assessment, in a manner consistent with the attribute being measured, of the probability that future inflows or outflows of economic benefits or services will result from the item. Recognition decisions also incorporate the results of assessments of the materiality and benefit versus cost of recognizing the item measured. Thus, it is possible that an item that meets the basic recognition criteria would not be recognized due to measurement, materiality, or cost-benefit considerations.[11]

Consideration of Asset Recognition or Disclosure

A30. Recognition of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves as an asset was considered by the Board based on SFFAC 5, paragraphs 18 through 35.

A31. An asset for federal accounting purposes is a resource that embodies economic benefits or services that the federal government controls.[12]

A32. To meet the definition of an asset of the federal government, a resource must possess two characteristics. First, it must embody economic benefits or services that can be used in the

[10] SFFAC 5, par. 5.

[11] SFFAC 5, par. 7.

[12] SFFAC 5, par. 18.

future. Second, the government must control access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.[13]

A33. First, the Board established which federal oil and gas resources were being considered. *Figure 1 – Components of Federal Oil and Gas Resources* presents the federal oil and gas resources that were considered. The two major components are "undiscovered resources" and "reserves." All of the federal oil and gas resources qualify as federal government assets because the government can obtain economic benefits and regulate the access of other entities as provided under federal law.

A34. Since all federal oil and gas resources controlled by the federal government are assets, the Board's next step was to decide whether the federal oil and gas resources "asset" should be recognized on a federal component entity balance sheet. As noted in paragraph A28 above, the second criterion for recognition is that the asset "…be measurable."

A35. Estimates of the quantity of technically recoverable oil and gas resources were available through EIA in the past. With this quantity information, a monetary measure was technically feasible and, therefore, the asset qualified for consideration for recognition. However, the Board does not believe that the information is sufficiently reliable to be recognized in a cost-beneficial manner.

A36. The EIA information on other than proved reserves is derived from sporadic and incomplete national assessments and annual submissions by oil and gas producers. This makes it particularly uncertain. In addition, since these reserves are not currently under lease, determining the royalty share may be misleading since it is a current value measure but the underlying asset may be restricted and production may never occur. For those resources that are not restricted, production may occur but the timing and amount of royalties are very uncertain. Thus, applying the same measurement technique to other than proved reserves may not result in a value that represents what it purports to represent. Therefore, federal oil and gas resources not yet in the "proved reserves" category would not be recognized on the federal balance sheet due to concerns regarding reliability of the proposed measure.

A37. SFFAC 1, *Objectives of Federal Financial Reporting*, provides the following with respect to reliability:

> 160. 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 represent faithfully the

[13] SFFAC 5, par. 22.

underlying events and conditions, nor should anything be included that would likely cause the information to be misleading to the intended report user. Reliability 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. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.

A38. Concerning the proved oil and gas reserves from federal oil and gas resources, the Board believes that both the quantity and the estimated federal royalty share would be reliable. Thus, in this case, since the quantity of the estimated federal proved oil and gas reserves can be reliably estimated and converted to monetary terms (estimated federal royalty share), the Board believes the estimated federal royalty share of proved oil and gas reserves should be presented as basic information. However, members would like to have more information on the reliability of the valuation methodology before it makes a final decision on whether the information should be recognized on the face of the financial statements or disclosed in the notes to the financial statements. Therefore, the Board has decided to require the information to be reported in a schedule of estimated federal oil and gas petroleum royalties in RSI for three years. Before the end of the three-year period, the Board will make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure.

A39. The Board acknowledges that royalties received from federal oil and gas leases will continue to be recognized on the statement of changes in net position with non-exchange revenue rather than on the statement of net cost with other exchange revenue as long as the asset value is reported as RSI and not recognized in the financial statements with a corresponding depletion expense. However, as noted above, the Board would like to have more information before it makes a final decision regarding changes to revenue recognition.

A40. While the Board intends to require that the information transition to basic information as financial statement recognition or note disclosure, the Board acknowledges that new information might become available that would warrant continued reporting as RSI. The Board will consider its reporting options after additional information becomes available.

Measurement Attributes and Methods Considered

A41. The FASAB's projects to reexamine and expand its conceptual framework include a project on measurement attributes (i.e., the aspect of an item that is measured, such as, for example, its historical cost or replacement cost) for reporting purposes. This project follows logically from SFFAC 5, which states that an item's being measurable is a criterion for recognition in the financial statements but does not address measurement attributes or measurement methods.

A42. As is true of other components of an expanded conceptual framework, the project on measurement attributes is expected to result in a concepts statement for the future guidance of, primarily, the Board itself. The statement may include definitions and a discussion of the features of different measurement attributes and methods as well as other concepts that should assist the Board in developing future standards. While the project on measurement attributes is underway, the Board will select the measurement attributes for each standard under deliberation based on available definitions.

A43. Concerning the dollar amount to be reported for the estimated federal royalty share of proved reserves, the Board considered various measurement attributes and methods, including the following:

a. Historical cost (historical proceeds) – The amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations.

b. Fair value –The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

c. Net realizable (settlement) value – The total non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion. The net realizable value requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash.

d. Present (or discounted) value of future cash flows – The present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows.

A44. After deliberating on the above attributes and methods, the Board decided that defining a measurement attribute in terms that are common to the oil and gas industry would be the best approach. Therefore, the Board proposed to use a regional average first purchase price for oil and lease condensate, a regional average first purchase price for **natural gas plant liquids** (NGPLs), and a regional average wellhead price for gas to value federal estimated petroleum royalties. This measurement approach was included in the May 2007 ED.

A45. Also included in the May 2007 ED was an alternative view from the Board member representing the Congressional Budget Office, expressing the view that fair value is the appropriate basis for valuing federal oil and gas resources. At the time, the other Board members had rejected fair value because of the lack of current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves.

A46. In conjunction with the comment period on the May 2007 ED, the Board requested that the proposal be field tested by the U.S. Department of the Interior (DOI). After reviewing the results of the field testing performed by DOI (see paragraphs A61 through A68) and talking with DOI representatives (see paragraphs A69 and A70) about the alternative methodology that it developed, the Board determined that the estimates that are developed should approximate the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible. In addition, discount rates as of the reporting date for present value measurements of federal oil and gas assets and liabilities should be based on interest rates on marketable Treasury securities with maturities consistent with the cash flows being discounted.

A47. While present value is typically considered to be a method for measuring fair value, the present value measurement approach required by this standard is based on an entity-specific discount rate, specifically the interest rates on marketable Treasury securities, and does not consider the price that market participants demand for bearing the uncertainty inherent in the cash flows (i.e., neither the cash flows nor the discount rate is adjusted for a market risk premium). A typical fair value measurement (e.g., Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements*[14]) is determined based on the assumptions that market participants would use in pricing the asset. A measurement that does not include an adjustment for the market risk premium would not represent a fair value measurement since market participants would include one in pricing the petroleum royalties. Therefore, the present value measurement approach required by this standard is not a market-based fair value measure.

A48. There is some concern that DOI may not be able to implement and/or obtain a favorable audit opinion on the present value methodology that it proposed as a result of its field testing. To permit additional flexibility in the measurement methods for valuing federal estimated petroleum royalties, the Board has also determined that market-based methods for measuring fair value or other methods for measuring current price will be acceptable. Fair value incorporates the effects of uncertainty that are inherent in the cash flows expected in the future from oil and gas activities, including the effects of the additional return demanded by market participants to assume the risk of that uncertainty. Therefore, the

[14] FASB Accounting Standards Codification™ (ASC) 820-10.

standard provides for a measurement method that is based on either (1) the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date using a risk-free discount rate without incorporating market risk, (2) market-based methods for measuring fair value, or (3) other methods for measuring current price.

Asset Valuation Methodology

A49. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect these changing conditions. Sources of information that were once available to preparers may be replaced or become obsolete. On the other hand, new and more reliable data sources may become available. Permitting the preparers flexibility in developing an estimation methodology that keeps pace with the environment will prevent the accounting standards from becoming outdated.

A50. EIA has been used as the source of information on proved reserves data in the past and may prove to continue to be the appropriate source for such information in the future. However, the Board has chosen not to explicitly designate EIA as the source of information; an explicit designation of the source of information would prevent the preparer from fully complying with the standards if the source were no longer available at some point in the future.

Use of Regional Data to Value the Federal Asset "Estimated Petroleum Royalties"

A51. The Board believes that the most relevant, reliable, and cost-beneficial measurement of "estimated petroleum royalties" would be obtained by using regional information. The Board believes this approach would provide conservative, representative regional values of estimated petroleum royalties without having to calculate the value on a field-by-field basis. The Board believes it would not be practicable to make calculations on a field-by-field basis. There are more than 60,000 leases maintained by DOI with approximately 115,000 producing wells.

Consideration of Liability Recognition or Disclosure

A52. Recognition of royalty distributions to non-federal entities as a liability was considered by the Board based on SFFAC 5 paragraphs 36 through 48.

A53. A liability is a present obligation[15] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[16]

A54. A liability of the federal government has two essential characteristics. First, a liability constitutes a present obligation to provide assets or services to another entity. Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled.[17]

A55. Paragraph 15 requires that the component entity responsible for collecting royalties report the value of the federal government's estimated petroleum royalties in a schedule of estimated federal oil and gas petroleum royalties. The value of the estimated petroleum royalties would be based on the royalty share of the federal oil and gas resources classified as "proved reserves." In addition to the royalties that the component entity collects on proved reserves that are produced, it also collects lease sale and rent revenue from federal government oil and gas leases. The component entity distributes nearly all of these proceeds to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments) in accordance with legislated allocation formulas. The component entity also receives a very small portion of the revenue collected to fund its operations. The amount used to fund its operations is legislated by Congress as part of the component entity's annual appropriation. For example, the amount received by the component entity was approximately one percent (1%) of annual revenues collected in 2006.[18]

A56. The Board believes that in addition to presenting a schedule of the estimated petroleum royalties to be received, the component entity responsible for collecting royalties should also present a schedule of the estimated petroleum royalties to be distributed to others because nearly all of the revenue from royalties, lease sales, and rent are ultimately distributed to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments).

[15] The term obligation is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

[16] SFFAC 5, par. 39.

[17] SFFAC 5, pars. 41 through 48.

[18] The one percent was derived by dividing [Note 23. Custodial Distributions to MMS, Revenues to Fund Operations] by [Total Revenue on the Statement of Custodial Activity] for 2006.

Future Rights to Royalty Streams Identified for Sale

A57. When rights to a future royalty stream are identified to be sold, the value of those rights should be reported in RSI as "future royalty rights identified for sale." Reporting the approximate value at the balance sheet date alerts the reader to the pending sale and the potential value of the asset to be sold.

A58. The value of the future royalty rights identified for sale is based on the specific field identified for sale. Because the fields are known, this provides a more field specific value for the rights identified to be sold.

Original Exposure Draft

A59. The original ED, *Accounting for Federal Oil and Gas Resources*, was issued May 21, 2007 with comments requested by September 21, 2007. However, because the Board received a request for the comment period to be extended and because few responses had been received, the Board agreed to extend the comment period until January 11, 2008.

Comment Letters

A60. Eight comment letters were received on the original ED. The following points present a high-level summary of the comments received:

a. The majority of respondents agreed with the overall concept of recognizing an asset for the federal government's natural resources and a liability for the related royalty revenues designated to be distributed to others.

b. Two of the eight respondents stated that standards on federal natural resources should include all federal natural resources and not be limited to only oil and gas resources.

c. One of the eight respondents commented on the complex nature of the original ED.

d. No respondents supported the use of the probabilistic method of estimation as proposed in the alternative view of the original ED.

e. Two respondents supported the use of present value or fair value with discounting (similar to the alternative view proposal) instead of the valuation method as proposed in the original ED that utilizes the average first purchase or wellhead price.

f. The majority of respondents agreed that the numerous disclosures proposed in the original ED appeared excessive and might not pass a cost/benefit test.

g. There was general support for royalty relief disclosures.

h. Of the five respondents that directly addressed the question on fiduciary disclosures, four stated that the cost of such disclosures would outweigh any perceived benefits.

i. The majority of respondents supported the recommendation for more limited disclosures in the CFR. However, one respondent stated that because natural resources are sovereign assets, the major disclosures would more appropriately appear in the CFR and not agency financial statements.

Field Testing

A61. In addition to the comment letters received on the original ED, the Board also considered the results of a field test of the proposed standards performed by a DOI field test team. The field test team consisted of MMS Offshore Minerals Management Economics and Resource Evaluation experts and petroleum engineers; Bureau of Land Management petroleum engineers and resource evaluation experts; and MMS Custodial Reporting Branch senior accountants with expertise in financial reporting.

A62. Field tests are part of FASAB's due process and help FASAB to establish effective standards. Participating federal entities volunteer to go through the exercise of "implementing" the proposed standards as if they were in place and then provide feedback to FASAB regarding the process. Field tests can proactively identify potential problems related to the implementation of proposed standards and allow FASAB to gather valuable information about implementation costs.

A63. The field test team presented the Board with a number of significant considerations, including the lack of availability of quantity information on proved reserves under federal lands. The original ED had proposed that the valuation of federal oil and gas resources be based on information to be provided by EIA on quantity of proved reserves under federal lands. However, this information has not been made available as of the date of the revised ED, and does not appear to be forthcoming.

A64. In addition to the reliance on proved reserves data required to be provided by EIA, the field test team noted a number of other concerns, including:

a. the desire to divide proved reserves by type of commodity (e.g., **crude oil**, lease condensate, and natural gas) and compute the asset value separately;

b. the need to develop a methodology for determining what portion of all proved reserves fall under federal domain;

c. the need to exclude royalty relief volumes and estimate the value of commodities received in kind and delivered to the Department of Energy to fill the Strategic Petroleum Reserve;

d. the effect of intermediate production between the effective date of the reserves estimate and the effective date of the booked value;

e. the effect of estimates such as the royalty accrual and prior year production adjustments made in the current year;

f. how to distinguish between long and short-term liabilities for the associated liability for revenue distributions to others;

g. appropriate treatment of interest payments related to oil and gas or commodities other than oil and gas once the custodial provisions are deleted from SFFAS 7 (paragraphs 45, 275, and 277);

h. the impact of material intragovernmental transactions and eliminations on the year-end reporting process; and,

i. the need to revise all, or almost all, of the existing posting models in the accounting system.

A65. The field test team also completed a field test questionnaire using a present value approach. This questionnaire included many of the same concerns as noted in paragraphs A63 and A64 above. In addition, the present value approach also incorporated present value calculations for factors such as the present value of royalties received over time, estimates of future gas prices, transportation allowances, and discount and inflation rates.

A66. In both estimates (the ED view as well as the present value view), the field test team used share of production as a proxy for share of proved reserves. One of the members expressed concerns about the use of production as a proxy for underlying reserves because it assumes (1) the same percentage of reserves are brought to market each year from all locations (or at least, on average between federal and non-federal) and (2) too much year to year variance in production patterns makes underlying reserve estimates fluctuate by an equal amount.

A67. Staff asked an oil and gas analyst at the Congressional Budget Office for his thoughts on the methodology. He responded that he understands the concern with the first assumption because it is likely that not the same fraction of reserves will be accessed in each year. However, he stated that averaging between federal and non-federal would control for some of that variance, though it is not possible to know just how much. He stated that this simplifying assumption is fairly reasonable given the approximate nature of the analysis. The analyst noted that with the second assumption, the variance might be eliminated or reduced by using a moving average rather than a year-to-year measure. For example, a 5-year or 10-year moving average of total federal production over total production would control some of the yearly differences between federal and non-federal.

A68. The field test questionnaires were extremely useful in helping the Board develop the standards proposed in the revised ED.

Discussion with DOI Representatives

A69. In addition to the Board's consideration of the comment letters received and the field test questionnaires, three members of the field test team and two representatives from DOI's Office of the Secretary met with the Board at the October 23, 2008, meeting to discuss issues raised in its comment letter on the original ED and the related field test questionnaires.

A70. At that meeting, DOI representatives indicated that they would be open to having less detailed implementation guidance in the standards if they were given a longer implementation period (two to three years) with a phase-in from RSI to basic information, and the ability to return to FASAB for implementation guidance if a reasonable methodology could not be agreed to by the auditors.

Revised Exposure Draft

A71. The revised ED, *Accounting for Federal Oil and Gas Resources*, was issued July 6, 2009, with comments requested by September 8, 2009.

A72. Upon release of the revised ED, notices and press releases were provided to The Federal Register, *FASAB News, The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past.

A73. This broad announcement was followed by direct mailings or e-mails of the revised ED to:

a. Relevant congressional committees: Senate Committee on Energy and Natural Resources, Senate Committee on Finance, Senate Committee on Indian Affairs, House Committee on Financial Services, and House Committee on Natural Resources;

b. Public interest groups and think tanks: National Congress of American Indians (NCAI), national and regional; Alliance to Save Energy; Brookings Institution; Cato Institute; Center on Budget and Policy Priorities; Citizens Against Government Waste; The Concord Coalition; The Heritage Foundation; National Parks Conservation Association (NPCA); Natural Resources Defense Council (NRDC); OMB Watch; Resources for the Future (RFF); Sierra Club; Urban Institute; and World Resources Institute (WRI);

c. Respondents to the prior ED (or their successors);

d. Agencies that manage and/or account for federal natural resources: DOI; Department of Agriculture (USDA), Deputy CFO; USDA Forest Service; and DOI Bureau of Land Management;

e. The Oil and Gas Industry: World Petroleum Council (WPC), American Petroleum Institute (API), Society of Petroleum Engineers (SPE), and Ryder Scott Company; and,

f. Other: DOI, Office of the Special Trustee (OST); Energy Information Administration (EIA); Department of Energy, Deputy CFO; Securities and Exchange Commission; U.S. Geological Service (USGS); and KPMG (DOI's financial statement audit partner).

A74. In addition, the ED was publicized during the FASAB Update session at the Financial Statement Audit Network monthly meeting on July 21, 2009, and at the Department of the Treasury's 19th Annual Government Financial Management Conference on August 5, 2009.

A75. To encourage responses, reminder notices were sent to the FASAB Listserv and each of the above individuals/organizations on August 20, 2009.

Comment Letters

A76. Nine comment letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		2
Auditors	1	
Preparers and financial managers	6	

A77. The following provides a high-level summary of the comments received on the revised ED:

a. The majority of respondents agreed that federal entities should be provided with flexibility in developing the asset valuation estimation methodology. DOI also agreed with the provision of flexibility with the caveat that a more detailed implementation guide be developed.

b. The majority of respondents agreed with the board's selection of present value of future federal royalty receipts on proved reserves known to exist as of the reporting date as the preferred measurement method. DOI also agreed with the preferred measurement method but noted that the proposed valuation from their field test questionnaire was based upon OMB's economic assumptions about future Treasury marketable security rates.

c. Half of the respondents agreed with the board's proposal to permit an alternative market-based fair value measurement consistent with FASB SFAS 157, *Fair Value Measurement*, if it is not reasonably possible to estimate using present value. One of the respondents disagreed with the use of fair value based on SFAS 157 because the oil and gas market is so volatile. DOI also agreed with the provision of an alternative measurement method but disagreed with the use of fair value based on SFAS 157 because they do not think the asset should be measured at a market exit price[19] since it is extremely unlikely that the asset would ever be sold.

d. The majority of respondents agreed that federal entities should be permitted to change their methodology for valuing the federal government's estimated petroleum royalties if environmental or other changes would provide for the development of an improved methodology. One respondent disagreed on the basis that it could impair the government's ability to prepare consolidated financial statements for the federal government.

e. The majority of respondents agreed that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided in SFFAS 33. DOI also agreed with the provision of guidance on reporting gains and losses with the caveat that a more detailed implementation guide be developed.

f. Half of the respondents agreed with the disclosure requirements for oil and gas fiduciary activities. Two respondents disagreed because they have cost/benefit concerns. One respondent disagreed partly because of cost/benefit concerns and

[19] Exit price is the price that would be received to sell an asset or paid to transfer a liability (FASB ASC 820-10-20).

partly because fiduciaries are generally not required by other standards-setters to value non-cash assets. DOI agreed with the disclosures and indicated that the information could be fairly readily reported.

g. All of the respondents agreed with the three-year phase-in of information from RSI to basic information. However, as discussed more in number A77i below, the majority of respondents would prefer that, following the three-year phase-in period, the information be presented as basic information in the notes rather than recognized on the face of the financial statements.

h. There was not a consistent view among respondents regarding application of the standard to other types of natural resources. Two of the respondents agreed with the inclusion of paragraph 9 relating to other types of natural resources. One respondent did not believe that the ED provided enough detail to form a response. Another respondent preferred that FASAB explicitly require agencies to use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard for all types of natural resources. Another respondent—DOI—provided some clarifying language that they believed would help fill a void in guidance that could lead to potentially inaccurate or inconsistent reporting.

i. The majority of respondents agreed with the alternative view contained in the July 2009 revised ED, which proposed that, following the three-year transition period as RSI, the value of federal oil and gas resources and annual changes be disclosed as basic information in the notes, rather than recognized on the face of the financial statements. One respondent disagreed with the alternative view in the revised ED because they supported the eventual presentation of all natural resources on the face of federal financial statements. Another respondent disagreed with the alternative view in the revised ED on the basis that the quantity and value of oil and gas resources and related revenues and depletion expenses would be material to the financial statements of the entities reporting those items; therefore, the omission or misstatement of that information makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced.

A78. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised.

A79. After deliberating the comments received on the revised exposure draft, the majority of the Board voted to require the information as RSI for three years and then put the project back on the agenda after two years to decide whether the asset would be recognized in the financial statements or disclosed in the notes. The Board plans to utilize the experience gained by DOI and others during the RSI period to inform their decision regarding financial statement recognition versus note disclosure.

A80. After considering respondents' views on applying the standard on accounting for federal oil and gas resources to other types of natural resources, the Board directed staff to apply the requirements of this Statement to other types of natural resources through the issuance of a technical bulletin. A technical bulletin will provide another opportunity for respondents to directly comment on the standards as they relate to other types of natural resources.

A81. After debating the advantages and disadvantages of limiting the alternative measurement method to SFAS 157 fair value, as had been proposed in the revised ED, the Board unanimously agreed to broaden the acceptable alternative measurement methods during the RSI phase to allow for greater flexibility in development of a valuation methodology.

Board Approval

A82. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Illustrations

PLEASE NOTE: The examples in this Appendix are illustrative only; they are populated with ***hypothetical*** amounts and do not represent authoritative guidance. Illustrations are not provided for all requirements.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Estimated Federal Oil and Gas Petroleum Royalties
Asset Value as of September 30, 20X3
(in thousands)

Offshore	**Region 1**	**Region 2**	**Region 3**	**Region 4**	**Region 5**	**Total**
Dry Gas	$4,500,000	$3,960,000	$2,880,000	$3,240,000	$3,420,000	$18,000,000
Wet Gas	500,000	440,000	320,000	360,000	380,000	2,000,000
NGPLs	500,000	440,000	320,000	360,000	380,000	2,000,000
Oil	5,500,000	4,840,000	3,520,000	3,960,000	4,180,000	22,000,000
Condensate	250,000	220,000	160,000	180,000	190,000	1,000,000
Total Offshore	**$11,250,000**	**$9,900,000**	**$7,200,000**	**$8,100,000**	**$8,550,000**	**$45,000,000**
Onshore	**Region 1**	**Region 2**	**Region 3**	**Region 4**	**Region 5**	**Total**
Dry Gas	$2,625,000	$2,310,000	$1,680,000	$1,890,000	$1,995,000	$10,500,000
Wet Gas	250,000	220,000	160,000	180,000	190,000	1,000,000
NGPLs	250,000	220,000	160,000	180,000	190,000	1,000,000
Oil	3,000,000	2,640,000	1,920,000	2,160,000	2,280,000	12,000,000
Condensate	125,000	110,000	80,000	90,000	95,000	500,000
Total Onshore	**$6,250,000**	**5,500,000**	**$4,000,000**	**$4,500,000**	**$4,750,000**	**$25,000,000**
Total Offshore and Onshore	**$17,500,000**	**$15,400,000**	**$11,200,000**	**$12,600,000**	**$13,300,000**	**$70,000,000**

Schedule of Estimated Federal Oil and Gas Petroleum Royalties Asset Value as of September 30, 20X2 (in thousands)						
Offshore	**Region 1**	**Region 2**	**Region 3**	**Region 4**	**Region 5**	**Total**
Dry Gas	$5,250,000	$4,620,000	$3,360,000	$3,780,000	$3,990,000	$21,000,000
Wet Gas	1,000,000	880,000	640,000	720,000	760,000	4,000,000
NGPLs	1,000,000	880,000	640,000	720,000	760,000	4,000,000
Oil	7,250,000	6,380,000	4,640,000	5,220,000	5,510,000	29,000,000
Condensate	500,000	440,000	320,000	360,000	380,000	2,000,000
Total Offshore	**$15,000,000**	**$13,200,000**	**$9,600,000**	**$10,800,000**	**$11,400,000**	**$60,000,000**
Onshore	**Region 1**	**Region 2**	**Region 3**	**Region 4**	**Region 5**	**Total**
Dry Gas	$4,000,000	$3,520,000	$2,560,000	$2,880,000	$3,040,000	$16,000,000
Wet Gas	500,000	440,000	320,000	360,000	380,000	2,000,000
NGPLs	500,000	440,000	320,000	360,000	380,000	2,000,000
Oil	4,750,000	4,180,000	3,040,000	3,420,000	3,610,000	19,000,000
Condensate	250,000	220,000	160,000	180,000	190,000	1,000,000
Total Onshore	**$10,000,000**	**$8,800,000**	**$6,400,000**	**7,200,000**	**$7,600,000**	**$40,000,000**
Total Offshore and Onshore	**$25,000,000**	**$22,000,000**	**$16,000,000**	**$18,000,000**	**$19,000,000**	**$100,000,000**

Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others as of September 30 (in thousands)			
		20X3	20X2
Other Federal Agencies			
	Department of the Treasury	$56,000,000	$80,000,000
	Department of Energy	420,000	600,000
	Other[20]	1,330,000	1,900,000
Indian Tribes and Agencies		350,000	500,000
States and Others		10,500,000	15,000,000
	Total Estimated Petroleum Royalties to be Distributed to Others	**$68,600,000**	**$98,000,000**

Management of Federal Oil and Gas Resources

The Minerals Management Service (MMS) plays an integral part in the implementation of the President's national energy policy (NEP). The NEP is a comprehensive strategy designed to secure America's energy future by reducing dependence on foreign sources, increasing domestic fossil fuel production, improving energy conservation efforts, and developing alternative and renewable energy sources. The MMS is responsible for managing the nation's oil and natural gas resources on the Outer Continental Shelf (OCS) and the mineral revenues from the OCS and federal lands. The MMS management process can be broken down into six essential analysis components: pre-leasing, post-leasing and pre-production, production and post-production, revenue collection, fund disbursement, and revenue compliance.

Stewardship Policies for Federal Oil and Gas Resources

The MMS's responsibilities as stewards of the physical oil and gas resources on the OCS begin when the MMS conducts pre-leasing analysis activities, which include the assessment of oil and gas resources that may be offered for lease. Following the pre-leasing assessment, the MMS develops a plan for offering those resources to developers. In the case of oil and gas development, this planning process is designed to consider both the environmental and economic concerns of the nation by providing opportunities for input from the public, the private

[20]Material distributions should be listed separately by entity.

sector, states, and Congress. The MMS conducts public planning processes for each individual lease sale.

Once a sale is completed, the MMS evaluates the bids to ensure that the government will receive fair market value. The evaluation determines whether the bid can be accepted and a lease issued. Once a lease is assigned to a winning bidder, the MMS begins post-leasing and pre-production activities. These activities include a permitting and approval process for all exploration, development, and production activities proposed by the lease operators. MMS staff inspects each operation in order to confirm that all activities are conducted in an environmentally and physically safe manner. Similar inspections also occur during the production and post-production activities to help ensure the federal government is receiving accurate royalties from production and facilities are decommissioned in a manner that protects the environment.

Once a lease is in place, the federal government's share of production from both offshore and onshore operations may be recovered as royalty-in-value (RIV) or royalty-in-kind (RIK). Federal oil and gas leasing laws and lease terms provide the government with the option of receiving production royalty payments either in money ("in value") or oil and gas production ("in kind"). Through royalty revenue collection and fund disbursement, the MMS achieves optimal value by ensuring that all revenues from federal oil and gas leases are efficiently, effectively, and accurately collected, accounted for, and disbursed to states, other federal component entities, and the U.S. Treasury. The MMS also performs revenue compliance activities to ensure the federal government has received fair market value and that companies comply with applicable laws, regulations, and lease terms.

Through this mineral asset management process, the MMS serves as a leading mineral asset manager for the federal government, the states, and the American people.

Future Royalty Streams Identified for Sale

Future royalty streams from two specific oil fields have been identified to be sold.

The estimated value of the future royalty stream identified to be sold from field number one in the Gulf of Mexico is $4.8 million based on the following calculation: The royalty stream from one million barrels are to be sold at a $40.00 sale price per barrel per field number one first purchase price for oil with a 12 percent royalty rate for field number one.

The estimated value of the future royalty stream identified to be sold from field number two in the Gulf of Mexico is $2.7 million based on the following calculation: The royalty stream from 750 thousand barrels are to be sold at a $30.00 sale price per barrel per field number two first purchase price for oil with a 12 percent royalty rate for field number two.

The future royalty streams are expected to be sold sometime during the next fiscal year.

Revenue Reported by Category
Fiscal year 20X3
(in thousands)

	Federal Offshore	Federal Onshore	Total
Dry Gas Royalty	$900,000	$200,000	$1,100,000
Wet Gas Royalty	600,000	100,000	700,000
NGPLs Royalty	300,000	100,000	400,000
Oil Royalty	1,500,000	300,000	1,800,000
Lease Condensate Royalty	100,000	40,000	140,000
Subtotal	$3,400,000	$740,000	$4,140,000
Rent	$200,000	$40,000	$240,000
Bonus Bid	2,000	0	2,000
Subtotal	$202,000	$40,000	$242,000
Total	**$3,602,000**	**$780,000**	**$4,382,000**

Revenue Reported by Category
Fiscal year 20X2
(in thousands)

	Federal Offshore	Federal Onshore	Total
Dry Gas Royalty	$1,000,000	$225,000	$1,225,000
Wet Gas Royalty	700,000	150,000	850,000
NGPLs Royalty	400,000	150,000	550,000
Oil Royalty	1,600,000	325,000	1,925,000
Lease Condensate Royalty	100,000	60,000	160,000
Subtotal	$3,800,000	$910,000	$4,710,000
Rent	$200,000	$50,000	$250,000
Bonus Bid	3,000	0	3,000
Subtotal	$203,000	$50,000	$253,000
Total	**$4,003,000**	**$960,000**	**$4,963,000**

The above tables of revenue reported by category presents royalty revenue for dry gas, wet gas, natural gas plant liquids (NGPLs), oil and lease condensate, as well as rent revenue and bonus bid revenue, by offshore leases and by onshore leases for the current and prior reporting periods. In addition, totals for the dry and wet gas royalty revenue categories, NGPLs royalty revenue category, oil and lease condensate royalty revenue categories, the rent revenue category, and the bonus bid revenue category are reported, with a total for all revenue reported.

Estimated Petroleum Royalties
End of Fiscal Year 20X3

	Quantity (in thousands)	Purchase Price ($)	Royalty Rate (%)
Dry Gas (Mcf)	60,100,000,000	$4.00/Mcf	14.0%
Wet Gas (Mcf)	40,000,000,000	$4.00/Mcf	15.0%
NGPLs (Bbl)	2,000,000	$23.00/Bbl	9.0%
Oil (Bbl)	11,000,000	$40.00/Bbl	13.0%
Lease Condensate (Bbl)	2,100,000	$29.00/Bbl	15.0%

Estimated Petroleum Royalties
End of Fiscal Year 20X2

	Quantity (in thousands)	Purchase Price ($)	Royalty Rate (%)
Dry Gas (Mcf)	58,100,000,000	$5.00/Mcf	12.0%
Wet Gas (Mcf)	36,800,000,000	$5.00/Mcf	13.0%
NGPLs (Bbl)	1,900,000	$24.00/Bbl	8.0%
Oil (Bbl)	10,000,000	$42.00/Bbl	11.0%
Lease Condensate (Bbl)	2,000,000	$30.00/Bbl	13.0%

The tables above provide the quantity, purchase price, and royalty rate by category of estimated petroleum royalties at the end of the current and prior reporting periods.

Federal Regional Oil and Gas Sales Information

The tables on the following pages reflect sales volume, sales value, royalty revenue earned, and estimated value for royalty relief information for fiscal year 20XX.

Sales volume represents the quantity of a mineral commodity sold during the reporting period. Sales value represents the dollar value of the mineral commodity sold during the reporting period. Royalty revenue earned represents a stated share or percentage of the value of the mineral commodity produced.

Royalty relief is the reduction, modification, or elimination of any royalty payment due to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. The estimated value for royalty relief is an approximated calculation of royalty relief. The estimated value for royalty relief is calculated based on a formula developed by the Department of the Interior.

The sales volume, sales value, royalty revenue earned, and the estimated value for royalty relief are presented on a regional basis. The information is presented on a regional basis to provide users of the financial statements with the regional variances in the prices of oil and gas for decision-making purposes, to reflect the amount of royalty relief granted and to forecast future royalty revenue.

Federal Regional Oil and Gas Information
FY 20XX Dry Gas Information
(in thousands)

Region	Sales Volume (Mcf)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	2,800,000	$8,100,000	$1,200,000	N/A
[Region 2]	2,900,000	7,300,000	1,100,000	N/A
[Region 3]	3,000,000	7,700,000	1,200,000	4,000,000
[Region 4]	2,800,000	6,200,000	900,000	N/A
[Region 5]	2,700,000	4,500,000	700,000	N/A
Totals	**14,200,000**	**$33,800,000**	**$5,100,000**	**$4,000,000**

FY 20XX Wet Gas Information
(in thousands)

Region	Sales Volume (Mcf)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	1,800,000	$5,400,000	$800,000	N/A
[Region 2]	1,900,000	4,800,000	700,000	N/A
[Region 3]	2,000,000	5,100,000	800,000	N/A
[Region 4]	1,800,000	4,100,000	600,000	N/A
[Region 5]	1,800,000	3,000,000	400,000	N/A
Totals	**9,300,000**	**$22,400,000**	**$3,300,000**	**N/A**

FY 20XX Natural Gas Plant Liquids (NGPLs) Information (in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	500,000	$7,100,000	$1,000,000	N/A
[Region 2]	400,000	5,700,000	800,000	N/A
[Region 3]	500,000	10,200,000	1,400,000	3,200,000
[Region 4]	400,000	8,900,000	1,300,000	N/A
[Region 5]	300,000	7,200,000	1,100,000	N/A
Totals	2,100,000	$39,100,000	$5,600,000	$3,200,000

FY 20XX Oil Information (in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	300,000	$4,500,000	$700,000	N/A
[Region 2]	300,000	5,600,000	800,000	N/A
[Region 3]	100,000	1,800,000	100,000	N/A
[Region 4]	4,500,000	11,500,000	1,800,000	N/A
[Region 5]	4,500,000	9,100,000	1,700,000	N/A
Totals	9,700,000	$32,500,000	$5,100,000	N.A

FY 20XX Lease Condensate Information (in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	80,000	500,000	70,000	N/A
[Region 2]	70,000	600,000	90,000	N/A
[Region 3]	50,000	200,000	20,000	N/A
[Region 4]	500,000	1,200,000	200,000	N/A
[Region 5]	500,000	1,000,000	190,000	N/A
Totals	1,200,000	$3,500,000	$570,000	N/A

Appendix C: Abbreviations

ASC	FASB Accounting Standards Codification™
Bbl	Barrels
CFR	Consolidated Financial Report
DOI	Department of the Interior
ED	Exposure Draft
EIA	Energy Information Administration
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
Mcf	Thousand Cubic Feet
MMS	Minerals Management Service
OCS	Outer Continental Shelf
NGPLs	Natural Gas Plant Liquids
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States
USGS	U.S. Geological Survey

Appendix D: Technical Terms

The terms explained in Appendix D have specific technical meanings within the oil and gas industry and may be useful in applying the requirements of this Statement.

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Definitions of Resource and Reserve Components and Subcomponents

Provided below are definitions used by federal entities to describe oil and gas resource and reserve components and subcomponents.[21] This section of Appendix D defines the terms used in *Figure 1 – Components of Federal Oil and Gas Resources.*

Undiscovered Resources

Resources estimated from broad geologic knowledge or theory and existing outside of known fields or known accumulations are undiscovered resources. Undiscovered resources can exist in untested prospects on unleased acreage, or on undrilled lease acreage, or in known fields. In known fields, undiscovered resources occur in undiscovered **pools** that are controlled by distinctly separate structural features or stratigraphic conditions.

The Mineral Management Service (MMS) and the U.S. Geological Survey (USGS) formerly conducted national assessments of undiscovered oil and gas resources together. The former was responsible for the offshore while the latter was responsible for onshore and state waters. The last such assessment was in 1995. MMS updates their assessment approximately every five years in accordance with DOI's five-year leasing program, with the last update in 2006.[22] Since 1995, the USGS has not conducted an overall update for onshore and state waters, but has conducted assessments updates on a basin or area level.

The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic play analysis approach for resource appraisal.

[21] Unless otherwise noted, the definitions in this section were adapted from (1) the OCS Report, Estimated Oil and Gas Reserves, Gulf of Mexico, December 31, 2000, MMS 2003-050; available online at https://www.gomr.mms.gov/PDFs/2003/2003-050.pdf; last accessed December 2, 2009 and (2) the OCS Report, Estimated Oil and Gas Reserves Pacific Outer Continental Shelf as of December 31, 1997, MMS 99-0023; available online at http://www.mms.gov/omm/pacific/offshore/oil-gaspdfs/99-0023.pdf; last accessed December 2, 2009.

[22] MMS Assessment of Undiscovered Technically Recoverable Oil and Gas Resources of the Nation's Outer Continental Shelf, 2006 (MMS 2006 Assessment); available online at http://www.mms.gov/revaldiv/PDFs/2006NationalAssessmentBrochure.pdf; last accessed December 2, 2009.

Undiscovered resources are **hydrocarbons** estimated on the basis of geologic knowledge and theory to exist outside of known accumulations. They are presumed to occur in unmapped and unexplored areas. The speculative and hypothetical resource categories comprise undiscovered resources. Undiscovered resources are classified as either undiscovered non-recoverable resources or undiscovered recoverable resources.

- Undiscovered Non-Recoverable Resources

The portion of undiscovered petroleum-initially-in-place quantities not currently considered to be recoverable. A portion of these quantities may become recoverable in the future as commercial circumstances change, technological developments occur, or additional data are acquired.

- Undiscovered Recoverable Resources

An assessment provides estimates of undiscovered recoverable resources in two categories for federal offshore oil and gas resources. However assessments for federal onshore oil and gas resources provide information for only one, the undiscovered, conventionally recoverable resources. Both are described below:

1. Undiscovered, conventionally recoverable resources: The portion of the hydrocarbon potential that is producible, using present or reasonably foreseeable technology, without any consideration of economic feasibility.[23]

2. Undiscovered, economically recoverable resources: The portion of the undiscovered conventionally recoverable resources that is economically recoverable under imposed economic scenarios.

Reserves

In accordance with the Society of Petroleum Engineers (SPE), the World Petroleum Congresses (WPC), and the American Association of Petroleum Geologists (AAPG), the definition for "reserves" and the following explanatory paragraphs are presented as follows:[24]

> Reserves are those quantities of petroleum which are anticipated to be commercially recovered from known accumulations from a given date forward. All reserve estimates

[23] MMS Assessment of Undiscovered Technically Recoverable Oil and Gas Resources of the Nation's Outer Continental Shelf, 2003 Update; available online at http://www.mms.gov/revaldiv/PDFs/2003 NationalAssessmentUpdate.pdf; last accessed December 2, 2009.

[24] WPC/SPE/AAPG Petroleum Reserves Definitions – 1997; available online at http://www.spe.org/spe-site/spe/spe/industry/reserves/Petroleum_Reserves; last accessed December 2, 2009.

involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data.

The relative degree of uncertainty may be conveyed by placing reserves into one of two principal classifications, either 1) unproved or 2) proved.

Unproved Reserves

After a lease qualifies under Title 30, Section 250.115/116 of the Code of Federal Regulations, the MMS Field Naming Committee reviews the new producible lease to assign it to an existing field or, if the lease is not associated with an established geologic structure, to a new field. Regardless of where the lease is assigned, the reserves associated with the lease are initially considered to be unproved reserves. Unproved reserves are based on geologic or engineering information similar to that used in estimates of proved reserves, but, technical, contractual, economic, or regulatory uncertainties preclude such reserves from being classified as proved.

Unproved reserves may be divided into two subclassifications, possible and probable, which are similarly based on the level of uncertainty.

Unproved possible reserves are less certain than unproved probable reserves and can be estimated with a low degree of certainty, which is insufficient to indicate whether they are more likely to be recovered than not. **Reservoir** characteristics are such that a reasonable doubt exists that the project will be commercial. After a lease qualifies under Title 30, Section 250.115/116 of the Code of Federal Regulations, the reserves associated with the lease are initially classified as unproved possible.

Unproved probable reserves are less certain than proved reserves and can be estimated with a degree of certainty sufficient to indicate they are more likely to be recovered than not. Reserves in fields for which a schedule leading to a Development and Production Plan (DPP) has been submitted to the MMS have been classified as unproved probable.

Proved Reserves

Proved reserves can be estimated with reasonable certainty to be recoverable under current economic conditions, such as prices and costs prevailing at the time of the estimate. Proved reserves must either have facilities that are operational at the time of the estimate to process and transport those reserves to market or a commitment or reasonable expectation to install such facilities in the future. Proved reserves can be subdivided into undeveloped and developed.

Proved undeveloped reserves are classified proved undeveloped when a relatively large expenditure is required to install production and/or transportation facilities, a commitment by the operator is made, and a timeframe to begin production is established. Proved undeveloped reserves are reserves expected to be recovered from (1) yet undrilled wells, (2) deepening existing wells, or (3) existing wells for which a relatively large expenditure is required for recompletion.

Proved developed reserves are classified as proved developed when the reserves are expected to be recovered from existing wells (including reserves behind pipe). Reserves are considered developed only after necessary production and transportation equipment have been installed or when the installation costs are relatively minor. Proved developed reserves are subcategorized as producing or non-producing. This distinction is made at the reservoir level and not at the field level.

- Any developed reservoir in a developed field that has not produced or has not had sustained production during the past year is considered to contain proved developed non-producing reserves. This category includes reserves contained in non-producing reservoirs, reserves contained behind-pipe, and reservoirs awaiting well workovers or transportation facilities.

- Once the first reservoir in a field begins production, the reservoir is considered to contain proved developed producing reserves, and the field is considered on production. If a reservoir had sustained production during the last year, it is considered to contain proved developed producing reserves.

End of the terms in Figure 1 that are defined under the subheading **Definitions of Resource and Reserve Components and Subcomponents**

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Other Definitions

Adjustments: The quantity which preserves an exact annual reserves balance within each State or State subdivision. These adjustments are the yearly changes in the published reserve estimates that cannot be attributed to the estimates for other reserve change categories because of the survey and statistical estimation methods employed. For example, variations as a result of changes in the operator frame, different random samples or imputations for missing or unreported reserve changes, could contribute to adjustments.[25]

[25] Energy Information Administration, U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves 2007 Annual Report, Glossary (EIA 2007 Annual Report Glossary); available online at http://www.eia.doe.gov/oil_gas/natural_gas/data_publications/crude_oil_natural_gas_reserves/cr.html; last accessed December 2, 2009.

Basin: A depression in the Earth's surface that collects sediment (loose, uncemented pieces of rock or minerals).[26]

Bonus Bid: Leases issued in areas known to contain minerals are awarded through a competitive bidding process. A bonus bid, as used in this Statement, represents the cash consideration paid to the United States by the successful bidder for a mineral lease. The payment is made in addition to the rent and royalty obligations specified in the lease.[27]

Crude Oil: A mixture of hydrocarbons that exists in the liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities. Crude oil may also include: 1) small amounts of hydrocarbons that exist in the gaseous phase in natural underground reservoirs but are liquid at atmospheric pressure after being recovered from oil well gas in lease separators, and that subsequently are commingled with the crude oil stream[28] without being separately measured; and, 2) small amounts of nonhydrocarbons produced with the oil.[29]

Dry Gas: The actual or calculated volumes of natural gas which remain after: 1. The liquefiable hydrocarbon portion has been removed from the gas stream (i.e., gas after lease, field, and/or plant separation) 2. Any volumes of nonhydrocarbon gases have been removed where they occur in sufficient quantity to render the gas unmarketable.[30]

Estimated Petroleum Royalties: The estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources.

Estimated Production: The volumes of oil and gas that are extracted or withdrawn from reservoirs during the report year.

Estimated Value for Royalty Relief: The estimated value for royalty relief is the calculated approximation of royalty relief based on a formula developed by DOI.

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[26] The USGS "Geologic Glossary"; available online at http://www.nature.nps.gov/Geology/usgsnps/misc/glossaryAtoC.html; last accessed December 2, 2009.

[27] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior (MRM Glossary of Mineral Terms); available online at http://www.mrm.mms .gov/Stats/pdfdocs/glossary.pdf; last accessed December 2, 2009.

[28] A crude oil stream is crude oil produced in a particular field or a collection of crude oils with similar qualities from fields in close proximity, which the petroleum industry usually describes with a specific name, such as West Texas Intermediate (EIA-182 Domestic Crude Oil First Purchase Report Instructions; available online at http://www.eia.doe.gov/pub/oil_gas/petroleum/survey_forms/eia182i.pdf; last accessed December 2, 2009).

[29] EIA 2007 Annual Report Glossary.

[30] EIA Glossary, available at http://www.eia.doe.gov/glossary/; last accessed December 1, 2009.

Extensions: The reserves credited to a reservoir because of enlargement of its proved area. Normally the ultimate size of newly discovered fields, or newly discovered reservoirs in old fields, is determined by wells drilled in years subsequent to discovery. When such wells add to the proved area of a previously discovered reservoir, the increase in proved reserves is classified as an extension.[31]

Federal Oil and Gas Resources: Oil and gas resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

Field: An area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same general geological structural feature and/or stratigraphic trapping condition. There may be two or more reservoirs in a field that are separated vertically by impervious strata, laterally by local geologic barriers, or by both. The area may include one lease, a portion of a lease, or a group of leases with one or more wells that have been approved as producible.[32]

First Purchase Price: The actual amount paid by the first purchaser for crude oil as it leaves the lease on which it was produced.[33] A "first purchase" constitutes a transfer of ownership of crude oil during or immediately after the physical removal of the crude oil from a production property for the first time.

Gas: A mixture of hydrocarbon compounds and small quantities of various nonhydrocarbons existing in the gaseous phase or in solution with crude oil in natural underground reservoirs at reservoir conditions.[34]

Hydrocarbon: An organic chemical compound of hydrogen and carbon in the gaseous, liquid, or solid phase. The molecular structure of hydrocarbon compounds varies from the simplest (methane, a constituent of natural gas) to the very heavy and very complex.[35]

Lease: Any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, extraction of, or removal of oil or gas.[36]

[31] EIA 2007 Annual Report Glossary.

[32] MMS OCS Estimated Oil and Gas Reserves Gulf of Mexico, December 31, 2005 (MMS 2009-022); available online at http://www.gomr.mms.gov/PDFs/2009/2009-022.pdf; last accessed December 2, 2009.

[33] Adapted from Form EIA-182 Domestic Crude Oil First Purchase Report Instructions.

[34] EIA 2007 Annual Report Glossary.

[35] EIA Glossary.

[36] 30 U.S.C. §1702 (5).

Lease Condensate: A mixture consisting primarily of pentanes and heavier hydrocarbons which is recovered as a liquid from natural gas in lease or field separation facilities. This category excludes natural gas plant liquids, such as butane and propane, which are recovered at downstream natural gas processing plants or facilities.[37]

Natural Gas Plant Liquids (NGPLs): Those hydrocarbons in natural gas that are separated as liquids at natural gas processing plants, fractionating and cycling plants, and, in some instances, field facilities. Lease condensate is excluded. Products obtained include ethane; liquefied petroleum gases (propane, butanes, propane-butane mixtures, ethane-propane mixtures); isopentane; and other small quantities of finished products, such as motor gasoline, special naphthas, jet fuel, kerosene, and distillate fuel oil.[38]

Net of Sales and Acquisitions[39]: The net change in the quantity of reserve estimates, either positive or negative, as a result of reserves gained through purchase and deducted through sale during the report year.

New Discoveries in Old Fields: The volumes of proved reserves of crude oil, natural gas, and/or natural gas liquids discovered during the report year in new reservoir(s) located in old fields.[40]

New Field Discoveries: The volumes of proved reserves of crude oil, natural gas and/or natural gas liquids discovered in new fields during the report year.[41]

[37] EIA 2007 Annual Report Glossary.

[38] EIA Glossary.

[39] Acquisitions are the volume of proved reserves gained by the purchase of existing fields or properties, from the date of purchase or transfer (EIA 2007 Annual Report Glossary).

[40] EIA 2007 Annual Report Glossary.

[41] Ibid.

Oil: See Crude Oil.

Outer Continental Shelf (OCS): All submerged lands seaward and outside the area of lands beneath navigable waters. Lands beneath navigable waters are interpreted as extending from the coastline 3 nautical miles into the Arctic Ocean, the Atlantic Ocean, the Pacific Ocean, and the Gulf of Mexico, excluding the coastal waters off Texas and western Florida. Lands beneath navigable waters are interpreted as extending from the coastline 3 marine leagues into the Gulf of Mexico off Texas and western Florida.[42]

Play: A group of pools that share a common history of hydrocarbon generation, migration, reservoir development, and entrapment.[43]

Pool: A discovered or undiscovered accumulation of hydrocarbons, typically within a single stratigraphic interval.[44]

Proved Reserves: For crude oil and gas, proved reserves are the estimated quantities that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. For lease condensate and natural gas plant liquids, proved reserves are the estimated quantities demonstrated with reasonable certainty to be recoverable in future years in conjunction with the production of proved gas reserves, under existing economic and operating conditions.[45] The total quantity of proved reserves is calculated by adding the quantity of reserves reported as **revisions and adjustments**, **net of sales and acquisitions**, total recoveries and deducting **estimated production** during the report year.[46]

[42] MRM Glossary of Mineral Terms.

[43] MMS 2006 Assessment.

[44] Ibid.

[45] EIA 2007 Annual Report Glossary.

[46] For a more detailed explanation of proved reserves and its components, see the section of Appendix D titled Definitions of Resource and Reserve Components and Subcomponents.

***Region**: The term region or regional refers to the geographic area or areas for which estimated petroleum royalties are calculated.*[47]

Regional Estimated Petroleum Royalties: Regional estimated petroleum royalties means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources in each region.

Rent: Annual payments, normally a fixed dollar amount per acre, required to preserve the rights to a lease while the lease is not in production. A rent schedule is established at the time a lease is issued.[48]

[47]For example, offshore federal oil and gas resources have typically been classified into regions such as: Alaska Region – the Federal Outer Continental Shelf Alaska; Pacific Region – the Federal OCS Pacific (Washington, Oregon, and California); Gulf of Mexico (GOM) Region – the Federal OCS Gulf of Mexico (Texas, Louisiana, Mississippi, Alabama, and GOM portion of Florida); and Atlantic Region – the Federal OCS Atlantic portion of all East Coast States.

For onshore federal oil and gas resources, the U.S. Department of Energy typically divides the United States into regions, which are referred to as Petroleum Administration for Defense Districts (PADD), for planning purposes. The result is a geographic aggregation of the 50 States and the District of Columbia into five Districts, with PADD I further split into three sub-districts, as follows:

PADD I (East Coast): PADD IA (New England) – Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont; PADD IB (Central Atlantic) – Delaware, District of Columbia, Maryland, New Jersey, New York, and Pennsylvania; and, PADD IC (Lower Atlantic) – Florida, Georgia, North Carolina, South Carolina, Virginia, and West Virginia.

PADD II (Midwest) – Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, and Wisconsin.

PADD III (Gulf Coast) – Alabama, Arkansas, Louisiana, Mississippi, New Mexico, and Texas.

PADD IV (Rocky Mountain) – Colorado, Idaho, Montana, Utah, and Wyoming.

PADD V (West Coast) – Alaska, Arizona, California, Hawaii, Nevada, Oregon, and Washington.

[48]MRM Glossary of Mineral Terms.

Reservoir: A porous and permeable underground formation containing an individual and separate natural accumulation of producible hydrocarbons (oil and/or gas) which is confined by impermeable rock or water barriers and is characterized by a single natural pressure system.[49]

Revisions: Changes to prior year-end proved reserves estimates, either positive or negative, resulting from new information other than an increase in proved acreage (extension). Revisions include increases of proved reserves associated with the installation of improved recovery techniques or equipment. They also include correction of prior report year arithmetical or clerical errors and adjustments to prior year-end production volumes to the extent that these alter reported prior year reserves estimates.[50]

Revisions and Adjustments: The net change in the quantity of reserve estimates, either positive or negative, as a result of adding changes reported as revisions and adjustments during the report year.

Royalty: Any payment based on the value or volume of production which is due to the United States on production of oil or gas from the Outer Continental Shelf or federal lands, or any minimum royalty owed to the United States under any provision of a lease.[51]

Royalty-In-Kind: A program operated under the provisions of the Mineral Leasing Act of 1920 and the Outer Continental Shelf Lands Act of 1953. The federal government, as lessor, may take part or all of its oil and gas royalties "in kind" (a volume of the commodity) as opposed to "in value" (money). Under the oil royalty-in-kind program, the government sells oil at fair market value to eligible refiners who do not have access to an adequate supply of crude oil at equitable prices.[52]

Royalty Rate: A proportionate interest in the production value of mineral deposits due the lessor from the lessee in accordance with a lease agreement.[53]

Royalty Relief: Existing statutes authorize MMS to grant royalty relief to operators on the production of oil and gas resources from federal oil and gas leases. Royalty relief is the reduction, modification, or elimination of any royalty to operators to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases.[54]

[49] EIA 2007 Annual Report Glossary.

[50] Ibid.

[51] Adapted from 30 U.S.C. § 1702 (14).

[52] MRM Glossary of Mineral Terms.

[53] Ibid.

[54] 43 U.S.C. § 1337(a).

Sales Value: The proceeds received for the sale of a product. Sales value is calculated by multiplying the sales volume by unit price.

Sales Volume: The volume, or quantity, of the product that is sold. The sales volume is measured in thousand cubic feet (Mcf) for gas and in barrels (Bbl) for oil.

Technically Recoverable Resources: The term used to describe the total quantity of undiscovered recoverable resources and unproved reserves. Proved reserves are not included in the estimated quantity of technically recoverable resources.

Wellhead Price: The value of the purchased natural gas at the mouth of the well. In general, the wellhead price is considered to be the sales price obtainable from a third party in an arm's length transaction. Posted prices, requested prices, or prices as defined by lease agreements, contracts, or tax regulations should be used where applicable.[55]

[55] EIA Glossary.

Statement of Federal Financial Accounting Standards 39: Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards

Status

Issued	August 4, 2010
Effective Date	Upon issuance
Affects	Amends SFFAS 5, footnote 17.
Affected by	None.

Summary

The American Institute of Certified Public Accountants' (AICPA) Statements on Auditing Standards (SAS) AU section 560, *Subsequent Events*, includes accounting and financial reporting guidance that is not discussed in the authoritative literature that establishes accounting principles. The objective of this Statement is to incorporate that guidance into the authoritative literature of the FASAB. Insofar as AU Section 560 established principles pertaining to the preparation of basic information and required supplementary information (RSI)[1] it would be more appropriately included in the accounting and financial reporting standards of the FASAB than in the auditing literature. Accordingly, this Statement does not establish new accounting guidance but rather incorporates the existing guidance (to the extent appropriate in the federal government environment) into the FASAB standards. In developing this Statement, the FASAB also considered incorporating existing AICPA guidance regarding an entity's ability to continue as a going concern and related party transactions. However, for reasons presented in the basis for conclusions (Appendix A), the FASAB does not provide accounting standards in these areas at this time.

The requirements in this Statement will improve financial reporting by incorporating authoritative accounting and financial reporting literature into a single source and thereby better enabling entities to prepare basic information and RSI in conformity with generally accepted accounting principles (GAAP). The Statement addresses the circumstances under which an entity should recognize or disclose events or transactions occurring after the end of the reporting period but before issuance of the financial report.

[1] The FASAB is in the process of reclassifying all items of required supplementary stewardship information (RSSI). Once the Board reclassifies all the items, the RSSI category will be eliminated. Until such time, this Statement also applies to RSSI.

Table of Contents

Introduction

Purpose

1. Accounting and financial reporting guidance regarding **subsequent events**[2] has been included in SASs of the AICPA. The objective of this Statement is to incorporate that guidance into the Statements of Federal Financial Accounting Standards.

Materiality

2. 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

3. The requirements in this Statement are effective upon its issuance.

Accounting Standards

Scope

4. This Statement establishes accounting and financial reporting standards for subsequent events and applies to the accounting for, and disclosure of, subsequent events not addressed in other applicable GAAP.

5. Other applicable GAAP may address the accounting treatment of events or transactions that occur after the end of the reporting period but before the financial statements are issued. If an event or transaction is within the scope of other applicable GAAP, then an entity should

[2] Terms defined in the glossary (Appendix C) are in boldface type the first time they appear in this Statement.

follow the guidance in that applicable GAAP, rather than the guidance in this standard. The following are examples of other applicable GAAP that prescribe the accounting and disclosures for specific subsequent events. Note that this is not meant to be an exhaustive list.

- Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, par. 24.
- SFFAS 27, *Identifying and Reporting Earmarked Funds*, par. 23.
- SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, par. 33.

6. Also, this Statement amends SFFAS 5, *Accounting for Liabilities of the Federal Government*, footnote 17.

7. This Statement applies to the basic information and required supplementary information (RSI)[3] of all federal reporting entities that are presented in conformity with GAAP.[4]

Definitions

8. **Subsequent events**: Events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.

9. **Recognized events**: Subsequent events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI.

10. **Nonrecognized events**: Subsequent events that provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date.

[3] Basic information and RSI are required components of a financial report prepared in conformity with GAAP. In the federal government environment, a financial report is known as a Performance and Accountability Report or an Agency Financial Report and may include other components required by legislation or administrative directives.

[4] The FASAB is in the process of reclassifying all items of required supplementary stewardship information (RSSI). Once the Board reclassifies all the items, the RSSI category will be eliminated. Until such time, this Statement also applies to RSSI.

Subsequent Events

11. Events or transactions that affect the basic information or RSI sometimes occur subsequent to the end of the reporting period but before the financial report is issued. Some of those transactions and events (referred to as recognized events) require adjustments while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI.

12. Recognized events consist of those events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI. In evaluating the conditions on which the estimates were based, all information that becomes available prior to the issuance of the financial report should be used. The basic information or RSI as applicable should be adjusted for any changes in estimates resulting from the use of such evidence.

13. Identifying recognized events calls for the exercise of professional judgment and knowledge of the facts and circumstances. The receipt of information regarding the impairment of an asset or the incurrence of a liability subsequent to the end of the reporting period may be indicative of conditions existing at the end of the reporting period, thereby calling for adjustment of the basic information or RSI before the issuance of the financial report. For example, the settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the basic information if the event that gave rise to the litigation, such as a personal injury occurring on government property, had taken place prior to the end of the reporting period. In this example, the resolution of an uncertainty may confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

14. Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities will ordinarily require adjustment of the basic information or RSI because such events typically represent the culmination of conditions that existed over a relatively long period of time.

15. Nonrecognized events consist of those events that provide evidence with respect to conditions that did not exist at the end of the reporting period, but arose subsequent to that date. These events should not result in adjustment of the basic information or RSI. Some of these events, however, may be of such a nature that their disclosure in basic information or RSI is required to keep the basic information or RSI from being misleading. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the basic information or RSI because such changes typically reflect a concurrent evaluation of new conditions.

16. Examples of nonrecognized events that may require disclosure in basic information or RSI, but should not result in adjustment, include the enactment of legislation, after the end of the reporting period, to establish a major federal program or an appropriation to provide benefits or services to protect the public's health and safety during a major disaster that occurred after the end of the reporting period but before the financial report is issued. The disclosures should concern matters that will probably affect the judgments and decisions of those relying on the financial report.

17. When a financial report is reissued, certain events may have occurred subsequent to the original issuance that requires disclosure in the reissued financial report. Events requiring disclosure in the reissued financial report are those that are considered important to a user's understanding of the reissued financial report. These events, occurring between the time of original issuance and reissuance of the financial report, should not result in adjustment of the basic information or RSI unless the adjustment meets the criteria for the correction of an error or the criteria for prior-period adjustments as set forth in SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. This also applies for events occurring subsequent to the original issuance when a financial report is reissued in comparative form with a financial report of subsequent periods.

Effect on Current Standards

18. In addition, SFFAS 5, footnote 17 is amended as follows to conform to the above requirements:

> Contingencies are different from "subsequent events." ~~as used in the accounting/audit literature.~~ Subsequent events are events or transactions that affect the basic information or required supplementary information (RSI) and occur subsequent to the end of the reporting period but before the financial report is issued. ~~Balance Sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements.~~ Some of those transactions and events (referred to as recognized events) require adjustments to the basic information or RSI while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI. A subsequent event may affect a contingency by providing information that resolves an uncertainty related to a contingent liability and confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

Effective Date

19. The requirements in this Statement are effective upon its issuance.

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by FASAB 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

A1. Representatives of the AICPA requested that the U.S. accounting standards-setters consider adopting certain guidance for accounting and financial reporting issues that now reside in the professional auditing literature. In July 2008, the FASAB joined the Governmental Accounting Standards Board in responding to this request.

A2. The AICPA SASs address certain accounting and financial reporting issues not included in the FASAB's authoritative literature that establishes accounting principles. Those initially-identified issues concerned subsequent events, an entity's ability to continue as a going concern (going concern), and related parties. The FASAB believes that the presentation of principles used in the preparation of a financial report is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

Subsequent Events

A3. AU Section 560, *Subsequent Events*, discusses events or transactions that occur subsequent to the end of the reporting period but prior to the issuance of the financial report. Such events require either adjustment or disclosure in the basic information or RSI and the auditing literature discusses the two types of events for consideration.

A4. The FASAB believes that incorporating the accounting and financial reporting guidance essentially as it exists in the AICPA literature would only change the source of the guidance and not significantly affect practice. Upon evaluating the auditing literature for subsequent events, the FASAB decided that the guidance is readily adaptable to the federal government environment with only minor terminology enhancements.

Going Concern

A5. AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, identifies certain factors that could indicate that there may be substantial doubt about a non-governmental entity's ability to continue as a going concern and provides examples of information that an entity might disclose if the conditions warrant such disclosures. However, the FASAB considered the nature of the federal government and determined that going-concern as contemplated in the commercial sense is not applicable to federal government financial reporting. Additionally, the FASAB considered that related guidance has been developed as discussed below and, as a result, decided to exclude the going concern standard from the Statement.

A6. On September 28, 2009, the FASAB issued SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. This standard concerns the consolidated financial report (CFR) of the federal government and requires the reporting of information to help users determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. It will thereby facilitate assessments of the extent to which financial burdens without related benefits were passed on by current year taxpayers to future year taxpayers.

A7. On the other hand, the FASAB noted that some federal government component units may experience fiscal challenges and may need to seek additional funding from Congress to continue their missions. In such instances and because SFFAS 36 only applies to the CFR, the FASAB expects that the entity would address the matter in the Management's Discussion and Analysis (MD&A) section of its financial report. SFFAS 15, *Management's Discussion and Analysis*, paragraph 3 provides guidance for reporting information in an entity's MD&A.

Related Parties

A8. AU Section 334, *Related Parties*, attributes the requirement for related party disclosures to the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 850 (Statement of Financial Accounting Standards 57), *Related Party Disclosures*, and provides indicators of related party transactions. The FASAB determined that the related party guidance was not readily adaptable to the federal government and discussed the applicability of related FASAB projects and current federal financial reporting practices to the issue of related party transactions.

A9. The FASAB has an on-going Federal Entity project that is intended to define and characterize federal reporting entities and to establish criteria for including various organizational units in a reporting entity. Also, the project will involve research on the various types of relationships that the federal government has established to carry out its public policy functions. The FASAB believes that it would be premature to incorporate the related party guidance before it completes its Federal Entity project. Consequently, the FASAB decided to conduct research on related parties as part of the Federal Entity project and use the research results to develop related party guidance applicable to the federal government environment.

A10. In addition, the FASAB noted that federal agencies typically purchase goods and services from other federal agencies or organizational units within the same agency and the FASAB has provided guidance to assist in reporting this activity. The guidance includes, but is not limited to:

a. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*;

b. SFFAS 5, *Accounting for Liabilities of the Federal Government*;

c. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*; and

d. SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*.

A11. The FASAB expects that this statement will not alter current reporting practices. However, some are concerned that reporting practices may change if the auditing guidance changes before the Federal Entity project is completed. If so, the FASAB would issue a Technical Bulletin to assist the federal financial reporting community.

Exposure Draft

A12. The Board published the exposure draft (ED), *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, on October 20, 2009, with comments requested by December 28, 2009. Upon release of the ED, notices and press releases were provided to: the Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, and Government Accounting and Auditing Update, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past.

A13. This broad announcement was followed by direct mailings of the exposure draft to the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate, and the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives.

A14. The Board received 17 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		**2**
Auditors	**3**	**1**
Preparers and financial managers	**11**	
Totals	**14**	**3**

A15. Respondents agreed that accounting principles regarding subsequent events should be incorporated into the FASAB's authoritative literature and they generally agreed that the going concern and related party guidance were not readily adaptable to the federal government environment. While some respondents believed that it would be helpful to consider providing additional guidance, such as FASB requirements for subsequent events, the objective of the Board's project was to incorporate the guidance presented in the audit literature rather than developing additional guidance or requiring changes in current practices.

A16. In addition, some respondents believed that it would be helpful to clarify aspects of the statement. Particularly, a respondent noted that in federal financial reporting, the term *financial statements* may refer to a *financial report*. A financial report includes basic information, required supplementary information (RSI), and required supplementary stewardship information (RSSI),[5] and may include other accompanying information (OAI). The respondent believed that the Statement should be clarified to state that it applies to *basic statements* and disclosures. However, if the Statement applies to a financial report, it should clarify the components or categories of the report and how it applies to those categories. The Board clarified this concern by clearly indicating that the Statement applies to basic information and RSI. The Board's standards are authoritative for only the basic information and RSI and do not apply to the other portions of a document (e. g., Performance and Accountability Report, Agency Financial Report) in which basic information and RSI are included. Further, auditors of the financial statements have certain

[5] The FASAB has re-categorized all RSSI items except for stewardship investments. Once the FASAB reclassifies the remaining RSSI item, the category will be eliminated. See SFFAC 6, par. A15.

responsibilities to read OAI. Any identified material inconsistencies between OAI and the basic information and RSI and any identified material misstatements of fact in OAI would affect the audit and/or the auditor's report.

A17. Another respondent believed that the definition of subsequent events should explicitly state that subsequent events pertain to *material* events and transactions and the term *material* should be used throughout the Statement as applicable. Also, one respondent believed that the term *material* should be included in the definition of subsequent events presented in SFFAS 5, footnote 17. The Forward to the FASAB's *Pronouncements as Amended*, June 30, 2009, discusses the term *materiality*. It states,

> The Board intends that application of authoritative guidance be limited to items that are material. "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.

Consequently, paragraph 2 of the Statement provides the Board's position on the matter of materiality regarding this Statement.

A18. An additional respondent believed that the examples in paragraph 16 should be clarified to help readers understand what type of events should be considered nonrecognized events. The Board revised the examples of nonrecognized events in paragraph 16 to clarify that such events provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date. The examples include legislative enactments occurring subsequent to the end of the reporting period. Also, additional guidance was added to assist readers in determining nonrecognized events that should be disclosed.

Board Approval

A19. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
ASC	Accounting Standards Codification
AU	Auditing Standards codified by the AICPA
CFR	Consolidated Financial Report
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SAS	Statement on Auditing Standards
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 40: Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment

Status

Issued	May 11, 2011
Effective Date	For periods beginning after September 30, 2011. Earlier implementation encouraged.
Affects	SFFAS 6, par. 77, 78, 80, 82, 83, and 84.
Affected by	None.

Summary

Deferred maintenance and repairs (DM&R) is maintenance and repair activity that was not performed when it should have been or was scheduled to be and which is put off or delayed to a future period. Although DM&R is not sufficiently measurable to support recognition or disclosure as basic information, it is nonetheless a cost and has been reported as required supplementary information (RSI). Information about DM&R has been required because the information is important to help financial statement users assess the efficiency and effectiveness of the federal government's management of property, plant, and equipment. The Board believes reliable government-wide data are needed to assist users in making assessments related to property, plant, and equipment.

This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment* (PP&E). The amendments (1) clarify that "deferred maintenance" reporting includes deferred repairs, (2) revise the examples of maintenance and repair activities to better reflect current practices and encompass activities associated with heritage assets, multi-use heritage assets and stewardship land as well as equipment and other personal property, and (3) address issues related to the distinction between maintenance, repairs, and new capital expenditures.

These amendments represent a first step toward improving reporting on deferred maintenance and repairs. The Board is working, and will continue to work, closely with stakeholders interested in improving management of and reporting on federal PP&E and related deferred maintenance. By addressing definitional issues as a first step, the Board will facilitate continued cooperation with stakeholders toward improved financial reporting especially as it plans to address measurement and reporting issues.

Table of Contents

Introduction

Purpose

1. Issues regarding both federal real property management and DM&R are currently being addressed by stakeholders including members of Congress,[1] federal agencies[2] as well as federal and non-federal councils.[3] As part of a coordinated effort among key federal stakeholders, the Board is committed to providing timely guidance on issues currently being addressed. The Board believes clarifying the definition of maintenance and repairs is an important first step in improving the accounting and reporting of DM&R.

2. The objective of this Statement is to incorporate definitional changes in response to concerns raised by the financial and technical[4] communities. The Board also considered the findings of a Federal Facilities Council (FFC) Committee on Operations & Maintenance review of SFFAS 6. The major SFFAS 6 concerns it identified include: (a) different interpretations among agencies and auditors regarding what to report and how to report, (b) introduction of terms not used in the technical community, (c) terms in the maintenance definition loosely defined, and (d) terms in the maintenance definition not reflective of actual practice.

3. Additionally, the Board desires to improve and, where needed, develop accounting and reporting guidance relative to DM&R that best reflects or enhances current federal practices. SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS no. 6, Accounting for Property, Plant, and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, issued in April 1999, reclassified deferred maintenance (DM) to RSI

[1] Federal Real Property Disposal Enhancement Act of 2009. H.R. 2495, 111th Congress, 1st Session. Federal Real Property Disposal Pilot Program. S. 1667, 110th Congress, 2nd Session.

[2] Presidential Executive Order 13327, Federal Real Property Asset Management signed February 4th, 2004 established the following policy in Section 1,*" It is the policy of the United States to promote the efficient and economical use of America's real property assets and to assure management accountability for implementing Federal real property management reforms. Based on this policy, executive branch departments and agencies shall recognize the importance of real property resources through increased management attention, the establishment of clear goals and objectives, improved policies and levels of accountability, and other appropriate action."*

[3] *National Research Council (NRC) Study on Predicting Outcomes of Investments in Maintenance and Repair for Federal Facilities.* This study will be conducted by a panel of experts. The committee plans to finish its report by December 31, 2010.

[4] This Statement uses the phrase "technical community" to refer to agency personnel responsible for the management of property, plant, and equipment including technical issues such as maintenance and repair.

primarily as a result of auditor concerns. Since then, asset assessment methodologies have matured and Administration initiatives[5] have prompted agencies to develop condition assessment, measurement, and reporting systems. However, these methodologies and systems are not uniform throughout government, resulting in a lack of comparability.

Materiality

4. 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.

Standards

Scope

5. This Statement revises maintenance and repair (M&R) terminology in Statement of Federal Financial Accounting Standards (SFFAS) 6, as amended, by modifying the definition of maintenance and by replacing the term “deferred maintenance” with “deferred maintenance and repairs.”

Effect on Existing Standards - SFFAS 6

6. SFFAS 6, paragraph 78 is replaced with the following text:

> Maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition.[1] Activities include preventive maintenance; replacement of parts, systems,[1a] or components; and other activities needed to preserve or maintain the asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.

[5] Presidential Executive Order 13327.

[Footnote 1 – [1] The determination of acceptable condition may vary both between entities and among sites within the same entity. Management shall determine what level of condition is acceptable.]

[Footnote 1a – [1a] The term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property.]

7. The term "maintenance" is replaced with "maintenance and repairs" and conforming grammatical changes are made in the following paragraphs of SFFAS 6:

   a. Paragraph 77 – "Deferred maintenance <u>and repairs" are</u> ~~is~~ maintenance <u>and repairs</u>…

   b. Paragraph 80 – …for deferred maintenance <u>and repairs</u> may…

   c. Paragraph 82 – …in a forecast of maintenance <u>and repairs</u> expense, these forecasts may serve as a basis against which to compare actual maintenance <u>and repairs</u> expense and estimate deferred maintenance <u>and repairs</u>.

   d. Paragraph 83 –

   At a minimum, the following information shall be presented as required supplementary information for all PP&E (each ~~of the four~~ <u>category</u>~~ies~~ established in <u>SFFAS 6</u> ~~the PP&E standard~~ should be included).

   • Identification of each major class [footnote 6 to remain; omitted here for brevity] of asset for which maintenance <u>and repairs have</u>~~s~~ been deferred.

   • Method of measuring deferred maintenance <u>and repairs</u> for each major class of PP&E.

   • If the condition assessment survey method of measuring deferred maintenance <u>and repairs</u> 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 condition[footnote 7 to remain; omitted here for brevity] and a range or a point estimate of the dollar amount of maintenance <u>and repairs</u> needed to return <u>assets to their</u> ~~it to its~~ acceptable operating condition.

• 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 and repairs forecast and an explanation for any changes to the forecast,
– prior year balance of the cumulative deferred maintenance and repairs amount,
– the dollar amount of maintenance and repairs that was defined by the professionals who designed, built or manage the PP&E as required maintenance and repairs for the reporting period,
– the dollar amount of maintenance and repairs actually performed during the period,
– the difference between the forecast and actual maintenance and repairs,
– any adjustments to the scheduled amounts deemed necessary by the managers of the PP&E, [footnote 8 revised] and
– the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance and repairs.

[Footnote 8 - [8]Adjustments may be necessary because the cost of maintenance and repairs 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.]

• The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* provides for required supplementary information applicable to the U.S. government-wide financial statements for these activities.

e. Paragraph 84 – …noncritical amounts of maintenance and repairs needed……noncritical amounts of maintenance and repairs needed…

Effective Date

8. This Statement is effective for periods beginning after September 30, 2011. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. 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 Statement–not the material in this or other appendices –should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. In late 2008 the Board reviewed its technical agenda and initiated a DM project. The DM project was highly ranked by constituents who provided input on the Board's technical agenda. A FASAB task force was convened to study the findings of a past review and recent federal and industry developments. The task force is addressing issues in two phases – (1) definitions and (2) measurement and reporting. This Statement is the result of the definitions phase. It addresses areas the task force identified as needing clarification. The task force developed definitional options for the Board's consideration and the amendments in this Statement are intended to clarify important matters. The Board notes that the minimum required supplementary information currently required at paragraph 83 of SFFAS 6 may be further modified as a result of the outcome of subsequent work related to the measurement and reporting phase of this project.

Primary Goals of the Proposed Amendments

Goal of DM&R Reporting

A2. Concerning the goal of DM&R reporting, the Board believes there is confusion regarding what is required in the financial reports under the current definitions. The Board's ultimate goal for DM&R information is that it serves as a useful tool for all decision makers, including Congress, oversight bodies, management, and citizens. To be useful, it must provide information about needed M&R that has yet to be performed. Therefore, management should present a reasonable estimate(s) of the cost of maintenance and repair activities that it would have performed in support of its mission if resources had been available in the past. In addition, management should provide explanatory material.

A3. Achieving the goal of DM&R reporting requires many judgments regarding what is needed in each situation. These definitional changes are a first step in improving the usefulness of DM&R reporting. Several definitional issues were discussed by the task force. For some issues, changes were proposed and in others they were not. The primary issue for which a change was not proposed in the exposure draft was a definition of acceptable condition. The rationale for that decision is provided below. Issues addressed by the exposure draft and the Board's decisions are discussed following a summary of the exposure draft outreach and responses.

Acceptable Condition and Judgment

A4. M&R planning requires decisions about the level of condition to which an asset should be maintained – for example, "as new" condition or "fair" condition. When management elects to use the condition assessment survey method, SFFAS 6 also requires that information concerning requirements or standards for acceptable condition be reported; assisting users in understanding what condition the agency judges to be "acceptable." The Board acknowledges that a view exists among certain practitioners and users of DM&R information that because SFFAS 6 guidance allows decisions about acceptable levels of condition it is too flexible. Further, it requires agencies to rely heavily on unspecified human judgment in the area of "acceptable" condition.

A5. Preparers and users who hold this view opine that unless FASAB includes guidance defining "acceptable condition" in the DM&R standards, agencies will continue to have disparate goals regarding DM&R. In their opinion, this could lead to (a) inaccurate DM&R reporting because of inconsistent definitions of "acceptable condition," (b) flawed M&R planning, and (c) DM&R reporting that is not informative to readers. After careful consideration of this view, the Board believes that the guidance these preparers/users seek would be management policies. Providing such guidance is not an appropriate role for an accounting standards setting body. The Board believes that the standards provide general guidance to be coupled with managerial judgment based on such factors as agency mission and asset use. In the next phase of the project, the Board will ask the task force to consider factors that management might appropriately consider in determining acceptable condition.

Summary of Outreach Efforts

A6. The Exposure Draft was issued May 4, 2010 with comments requested by June 25, 2010. Upon release of the exposure draft, notices and press releases went to *The Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive,* the CFO Council, the Council of Inspectors General on Integrity and

Efficiency, the Financial Statement Audit Network; and members of both the Federal Real Property Council and the Federal Facilities Council and committees of professional associations generally commenting on exposure drafts in the past.

A7. This broad announcement was followed by direct mailings of the exposure draft to the House Committee on Oversight and Government Reform, the Senate Committee on Homeland Security and Governmental Affairs, and the American Association of State Highway and Transportation Officials.

A8. A reminder notice was provided on June 14th and professional associations were contacted via telephone on or about that date.

Responses to the Exposure Draft

A9. Thirty-four responses were received. Table 1.0 summarizes received responses by respondent type.

Table 1.0

Summary of Respondent Types to DM&R Maintenance Definition Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	28	1	29
Users, academics, others	1	2	3
Auditors	2	0	2
Total	31	3	34

A10. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss respondent comments and Board decisions.

Adding "Repairs" to Title and Body of Definition

A11. The task force reported much confusion regarding the proper treatment of repairs. Due to this confusion, some agencies may not be reporting deferred repairs. As a result, the Board proposed that the term "deferred maintenance" should be revised to "deferred maintenance and repairs." The majority of respondents agreed with the Board's proposal to add "repairs" to the title and body of the revised definition in order to clarify that deferred "repairs" as well as deferred "maintenance" need to be reported.

A12. Two respondents objected based on the assumption that "repairs" cannot be planned. However, this is not always nor usually the case. There are in fact many repairs that can be planned for based on historical and statistical analyses such as a study of failure rates. Also, not all repairs are of an emergency or corrective nature as some repairs are adaptive which lend themselves to planning. Some agencies have programs in-place that attempt to predict repairs and in some cases these predictions can cover over 90% of the repair activity over a two year time horizon. For example, roof maintenance plans include an analysis of the condition assessment which can forecast when a roof (or portion thereof) might fail and require repair.

A13. The remaining respondent who disagreed believes including repairs will cause continued confusion due to the lack of definition for this term. However, based on both the task force's recommendation as well as the majority of respondents who are in favor of this change, it is apparent that the community-at-large believes that including this term helps to clarify conflicting interpretations and divergent practices. Although the Board does not believe that from an accounting point of view, maintenance and repairs should be distinguished from each other, it does recognize that some within the technical community do make a distinction. Accordingly, the original definition[6] by virtue of excluding other than "normal" repairs" contributes to the underreporting of deferred maintenance and repairs as well as the lack of consistency both within and among agencies. While it is the Board's intention that for financial reporting purposes M&R not be treated separately, the Board acknowledges the view that maintenance generally retains an asset's functionality whereas repair generally restores an asset's functionality.

A14. It should be noted that although the Board believes that "repairs" should be added to the definition, it does acknowledge that various interpretations surrounding unique circumstances may warrant future guidance.

[6]SFFAS 6, paragraph 78.

Illustrative List of Activities

A15. The second sentence of the definition provides an illustrative list of activities which is not meant to be all inclusive. The Board believes that the list of activities contained in the second sentence of the existing definition should be changed to better reflect current federal and industry practices as well as encompass M&R activities related to heritage assets, multi-use heritage assets, stewardship land, equipment and other personal property in addition to buildings.

A16. In reviewing the reasons cited by the minority of respondents who disagreed with the proposed changes to the illustrative list of activities, it is clear that some of the issues raised should be dealt with via implementation guidance while others require Board clarification. Specifically:

a. Systems – One respondent objected to adding "systems" since it appeared confusing to include a term which relates to equipment along with terms associated with buildings. Another respondent objected to adding "systems" since it referenced information technology assets which are already included by virtue of being an asset class within property, plant, and equipment. The Board desires to clarify that the term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) which are in fact covered by SFFAS 6 as amended or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property. Furthermore, depending on an agency's capitalization criteria, systems and/or their replacements may or may not be capitalized. Because the maintenance and repair definition is an umbrella definition covering many categories and classes of assets, it would be both impractical and inappropriate to limit the meaning of terms such as "systems" that cut across such a broad spectrum of assets.

b. Greater Clarity of Terms – Two respondents sought greater clarity in each of the proposed terms. One respondent preferred retaining "normal repairs" since it distinguishes itself from major and extraordinary repairs. The Board believes that standards should be general. If needed, detailed guidance can be provided through implementation guidance. However, the Board will work with the task force to consider examples in the next phase of the project. In addition, agencies are encouraged to seek implementation guidance as needed before the effective date.

c. Eliminate entire list - One respondent preferred eliminating the entire list or at least excluding preventative maintenance entirely stating that maintenance work is routine, recurring, repetitive, and periodic in nature and as such is never deferred but rather extended. Thus, according to this respondent deferred maintenance is minor in magnitude and too difficult to measure and report. The Board does not subscribe to the notion that deferred maintenance and repair activities are immaterial in nature at all agencies. Furthermore, the Board's research and overall respondent support (from the community-at-large) for the proposed changes reflect that greater clarity and not less is needed in the definition.

d. Audit misapplication - One respondent was concerned that auditors will treat the list as all-inclusive. The Board desires to make it clear that the list is illustrative only and does not purport to identify all activities that an agency might consider to be either maintenance or repair.

e. Accounting for disposal costs - One respondent sought guidance on disposal activities. Disposal activities are beyond the scope of this project.

f. Information technology assets - One respondent sought inclusion of internal use software. As previously stated, this SFFAS 6 as amended in fact applies to all categories and classes of PP&E including internal-use software.

g. Impact on capitalization - One respondent was concerned that systems might be capitalized even though capacity increases or upgrades are not accomplished. The Board notes two points in this matter: (1) depending on an agency's capitalization criteria, systems and/or their replacements may or may not be capitalized and (2) it does not intend at this time making any definitional changes that would require an agency to change its capitalization policies or criteria.

Phrase Elimination:Acceptable Services and Expected life

A17. The majority of respondents agreed with the Board's proposal to eliminate the phrase, *"so that it continues to provide acceptable services and achieves its expected life."* Of the three respondents who disagreed, the following issues were raised:

a. One objected to removing the "useful [sic] life" reference since it takes away a key quantitative factor for the evaluation of management's determination of the relative length of time in which an asset's acceptable condition would be expected to be maintained, and undermines the concept of useful life recognition in the basic financial statements and notes.

b. One objected to deleting "acceptable services" since the term "acceptable condition" does not encompass "acceptable services." According to this respondent the term "acceptable services" seems more measurable and indicative of adequate functionality and support of mission than "acceptable condition."

c. One objected to both phrases being removed since the phrase “acceptable services” helps convey the meaning of “acceptable condition” and the phrase “expected life” is also useful as it helps set the boundaries of the FASAB definition - subsequent acquisitions that extend an asset’s “useful life” are capitalized and outside the scope of “deferred maintenance.”

A18. The Board considered each of the arguments presented and decided eliminating this phrase helps to eliminate ambiguity and reflect actual asset management practices.

a. First, the Board notes that the changes made to the maintenance and repairs definition are limited to the application of this standard in regards to presenting DM&R information in RSI. Therefore, elimination of the “expected life” reference does not infringe on management’s determination of an asset’s acceptable condition. Furthermore, because the definition is limited to DM&R, the Board does not believe the “expected life” concept used for capitalization and depreciation is impacted in any meaningful way.

b. To help eliminate confusion and clarify the intent regarding DM&R reporting, the Board desires to simplify the definition wherever practicable. Notwithstanding health and/or safety implications, the Board believes that the most basic function for an adequate M&R program is to keep an asset in an acceptable condition consistent with management’s expectations. Therefore, management is in the best position to first define and then assess whether or not a nexus exists between asset condition and “acceptable services.” Although the term “acceptable condition” may not always encompass “acceptable services,” management is responsible for that determination. Accordingly, undefined terms such as “acceptable services” that might have multiple meanings within an agency, let alone among agencies, run counter to the Board’s intent of clarification.

c. The Board believes that linking DM&R to an “expected life” estimate is not useful. From an operational perspective, M&R activities may not solely be performed for the purpose of allowing PP&E to achieve its expected life because health and safety considerations may be paramount. Furthermore, estimates of expected life may change over time due to operating conditions, actual maintenance practices, or technical changes. As an asset’s expected life changes, the life assigned in the accounting records should be appropriately updated. However, this presents practical problems if M&R is tied to meeting an expected life – for example, which expected life is to be used and what happens when the expected life is exceeded. Therefore, the Board believes that linking M&R to attainment of an expected life is not appropriate.

Originally intended vs. current use.

A19. Two issues were raised by respondents who did not agree with the proposed change from “originally intended” to “current use.” First, it was noted that “current use” will be misunderstood and misapplied and instead the Board should adopt the phrase “the use for which it is currently configured.” Second, it was noted that “current use” would be a poor benchmark for definitional purposes and that the original intent could in fact be ascertained via reviewing various agency documents. The Board notes that the task force considered the term proposed by the respondent and found it to be problematic because it introduces a new term without a consistent meaning. For example, the term “configure” raises questions as to definition. Specifically, “configured” when and by whom? Does this imply a purely technical configuration based on schematic drawings or operational configuration based on logistics? The Board does not wish to introduce new terms that could cause further confusion or create any additional ambiguity. Concerning the second issue, the Board notes that the task force found the opposite to be true: current use is the most appropriate benchmark especially when one considers changes in mission or code (i.e., construction, health, and/or safety) requirements over the years and that original intent cannot always be readily ascertained via a review of agency documents.

Other Comments

Capital Improvements

A20. One respondent raised a concern regarding the exclusion of capital improvements from DM&R reporting. Additionally, the Board has been made aware of several other concerns over this matter. The concerns include:

a. failure to include “Total Correction Costs” in the definition would significantly under report all costs to correct existing capitalized assets; e.g., maintenance, repairs and estimated capital improvements

b. some special purpose reports include unfunded capital needs along with DM&R information and this is beneficial to users

c. some repair activities may incidentally improve assets (e.g., damaged lighting fixtures may be replaced with more energy efficient lighting fixtures) and there is uncertainty regarding treatment of such projects

d. there is uncertainty regarding planned M&R activities relating to fully depreciated fixed assets and fixed assets that are not recognized in the accounting records due to capitalization thresholds

A21. The Board believes that the existing goal of differentiating those activities that might be considered capital improvements (or new assets) from M&R should be maintained. DM&R reporting addresses concerns about management of existing assets. While unmet capital needs (i.e., capital improvements and new acquisitions) are relevant to decision makers, they do not as clearly relate to reporting on past transactions and events as DM&R does. As such, unmet capital needs should not be included in the calculation of DM&R. DM&R arises because an asset exists that is not maintained in accordance with an agency's established M&R policy; DM&R have financial consequences apart from unmet capital needs which are relevant to decision makers.

A22. The Board is mindful that the distinction between M&R activities and improvements to existing assets is often not clear. Some M&R activities that could enhance an asset may not generally be considered by accountants as "capital improvements" and recognized as additions to the agency's assets. In addition, there will be uncertainty regarding the unit of analysis – whether an entire facility is "the asset" or its individual components are "assets." Therefore, depending on the unit of analysis, an activity might be considered M&R or replacement of an old asset with a new one. It is not the Board's intention that a precise distinction be attained in every case. Rather, agencies should not include new asset, capital improvement, and/or enhancement needs in DM&R and should treat like circumstances similarly over time since a consistently followed practice that is well described will assist decision makers.

A23. By reaffirming that M&R excludes capital improvements, the Board is striving to ensure the definition of DM&R for purposes of financial reporting will be one and the same as in the condition index[7] calculation of the Federal Real Property Profile (FRPP). This should result in agencies having to develop only one estimate of DM&R for both purposes.

A24. In the exposure draft, the Board sought not only input on the proposed changes, but also other changes, points, issues and/or considerations which may not have been specifically addressed in the exposure draft. Twenty-two respondents provided additional comments that covered a broad array of issues ranging from editorial notes to acknowledging the

[7] It should be noted that the revised maintenance and repair definition as contained in this standard is intended to be the basis for the numerator so that a uniform reporting requirement definition exists throughout federal government. ***Condition Index (CI)*** is a general measure of the constructed asset's condition at a specific point in time. *CI* is calculated as the ratio of Repair Needs to Plant Replacement Value (PRV). *Formula: CI = (1 - $repair needs/$PRV) x 100.* Source: 2009 GSA's Guidance For Real Property Inventory Reporting dated July 14, 2009.

positive effects of revising the definition as well as the ambitious nature of this project. In summary the comments received include:

a. One respondent suggested that the Board should not be overly prescriptive because one size does not fit all.

b. One respondent said the difficulty will be in transferring accounting requirements into the operations and maintenance arena.

c. One respondent suggested that the Board should consider distinguishing between types of repairs.

d. One respondent recommends that the Federal Real Property Council (FRPC) and the General Services Administration require agencies to report Active and Inactive DM.

e. One respondent suggested that guidance could be enhanced that DM&R applies to all classifications and classes of PP&E (i.e., in addition to real property). The Board notes that SFFAS 6, paragraph 83 requires DM&R information for each category of PP&E by major class.

f. One respondent stated that acceptable condition differs between equipment and facilities. For equipment it may be defined as mission-capable or serviceable.

g. One respondent suggested adding guidance on using GSA's FRPP information for the annual data calls. Replacement costs or ranges of such costs are needed to determine whether or not funding DM&R is economically advantageous compared to asset replacement.

h. One respondent stated that there is a borderline between financial reporting of DM&R and technical or project completion of M&R. In their opinion, M&R should be viewed over an asset's life-cycle and not by a financial reporting period.

DM&R on Non-capitalized General PP&E

A25. While views were sought on this issue, no changes in practice relating to DM&R on non-capitalized general PP&E should result from this Statement. SFFAS 6, paragraph 83, provides minimum reporting requirements. The Board will clarify these requirements during the next phase of this project.

A26. The Board asked if the respondents believed that DM&R reporting should be limited to DM&R related to capitalized general PP&E as well as non-capitalized stewardship PP&E or directed broadly to fixed assets. Sixteen respondents were in favor of reporting DM&R

broadly to fixed assets whereas fourteen respondents were in favor of limiting DM&R reporting to capitalized general PP&E as well as stewardship PP&E.

a. Respondents in favor of reporting DM&R broadly to fixed assets provided the following comments:

   i. DM&R should apply to all assets because capitalization thresholds are not recognized in asset management practices and should be consistent with GSA's Real Property profile (all assets).

   ii. DM&R on all fixed assets is a better indication of risk to the Government's varied missions.

   iii. Fixed assets relate better to M&R since all or most assets require maintenance.

   iv. Since there is confusion between what a capital asset is versus PP&E, DM&R should be reported under fixed assets.

   v. If an agency has a significant number of fully depreciated assets for which DM&R is reported, a reevaluation of useful life estimates is in order.

   vi. If an agency has a significant number of assets that do not meet its capitalization threshold for which the agency believes DM&R should be reported, a reevaluation of the capitalization threshold is in order.

   vii. Consideration should be given to allowing a threshold for DM&R reporting purposes that may or may not be different from the threshold used for capitalizing PP&E.

   viii. DM&R is more pertinent to users than depreciation or historical cost information inasmuch as it represents future costs to be incurred.

   ix. Limitations to DM&R reporting could cause potential data conflicts with other sources of information used by program and congressional offices.

b. Respondents in favor of reporting DM&R limited to capitalized general PP&E and stewardship PP&E provided the following comments:

   i. DM&R should retain association to PP&E. Adding DM&R for non-capitalized assets skews any resultant analysis to PP&E. DM&R should trace and be auditable to PP&E.

ii. Capitalization thresholds reflect cost/benefit considerations balancing the cost of precision versus the costs to compile data.

iii. If an asset is expensed, it has been deemed immaterial and DM&R should follow suit.

iv. A (separate) threshold for DM&R on non-capitalized assets should be allowed to encourage such reporting.

v. Apply a uniform DM&R threshold applicable only for government-wide reporting purposes.

vi. Reporting DM&R for fixed assets in essence undervalues the PP&E reflected on the balance sheet.

vii Establishing limits (definitions) for “fixed assets” will be very difficult in practice adding additional costs.

viii. Agencies should use judgment in determining whether DM&R be limited or applied broadly; user benefits should exceed costs of preparing said information.

Board Deliberations

A27. The Board discussed respondent input but has made a decision only regarding the proposed amendments to SFFAS 6 relating to the definition of DM&R. Input and suggestions regarding other topics will be considered in the next phase of the project – measurement, reporting and asset impairment. The basis for conclusions primarily addresses Board deliberations on definitional issues.

Board Approval

A28. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Abbreviations

CFO	Chief Financial Officers (Council)
DM	deferred maintenance
DM&R	deferred maintenance and repair
FASAB	Federal Accounting Standards Advisory Board
FFC	Federal Facilities Council
FRPC	Federal Real Property Council
FRPP	Federal Real Property Profile (GSA Asset Management Database)
GAAP	generally accepted accounting principles
GAO	Government Accountability Office
GSA	General Services Administration
M&R	maintenance and repair
OMB	Office of Management and Budget
PP&E	property, plant and equipment
RSI	required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 41: Deferral of the Effective Date of SFFAS 38, Accounting for Federal Oil and Gas Resources

Status

Issued	July 6, 2011
Effective Date	Effective upon issuance.
Affects	SFFAS 38, pars. 5 and 30, by replacing the year “2011” with “2012.”
Affected by	None.

Summary

This Statement defers the effective date of Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, for one year. The standards contained in SFFAS 38 will become effective as required supplementary information for periods beginning after September 30, 2012, with earlier implementation encouraged.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that report information about federal oil and gas resources in general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Amendment to SFFAS 38

2. Paragraphs 5 and 30 of SFFAS 38, *Accounting for Federal Oil and Gas Resources*, are amended as follows:

   The standards are effective as RSI for periods beginning after September 30, ~~2011~~2012. Earlier implementation is encouraged.

Effective Date

3. This standard is effective upon issuance.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. FASAB issued Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, on April 13, 2010. This standard requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves be reported in a schedule of estimated federal oil and gas petroleum royalties. In addition, this standard requires the value of estimated petroleum royalty revenue designated for others be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented as required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity. SFFAS 38 is effective as RSI for periods beginning after September 30, 2011 with earlier implementation encouraged.

A2. It is the Board's intent that the information required by SFFAS 38 transitions to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. SFFAS 38 will remain in effect until such time as a determination is made.

A3. On September 30, 2010, FASAB staff was informed that the Department of the Interior (DOI) was considering requesting a one-year deferral of the effective date of SFFAS 38 due to the recent reorganization of the Minerals Management Service (MMS) into several different bureaus under the newly created Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE). MMS had been the component entity responsible for collecting royalties and charged with preparing the information to be reported under SFFAS 38.

A4. On October 7, 2010, FASAB staff notified a BOEMRE representative that in order to issue an amendment to the standard by September 2011, staff would need to receive DOI's formal deferral request in time to prepare a draft exposure draft (ED) for the December 2010 board meeting.

Request for Deferral

A5. The formal request was received from BOEMRE on November 18, 2010. The request explained that MMS's successor organization will be divided into three new entities. First, the BOEMRE and the Bureau of Safety and Environment Enforcement will divide the duties of the former Offshore Energy and Minerals Management organization, with the former managing the development of conventional and renewable resources and minerals on the Outer Continental Shelf, and the latter providing safety and environmental oversight. These new bureaus will report to the Assistant Secretary of Land and Minerals Management. Second, the Office of Natural Resources Revenue (ONRR) will perform the roles of the former Minerals Revenue Management organization and report to the Assistant Secretary for Policy, Management and Budget.

A6. BOEMRE's request stated that many issues and challenges have arisen as a direct result of these organizational changes that will greatly complicate the implementation of SFFAS 38 for fiscal year 2012. Accordingly, a one-year deferral of SFFAS 38 was requested.

A7. While a reorganization in and of itself would not normally be a justification for deferring a standard, the Board members noted that the nature and extent of the MMS reorganization goes above and beyond what would be considered within the normal course of operations. The Board therefore approved the one-year deferral, but emphasized that earlier implementation is encouraged and strongly urged that the standard be implemented for fiscal year 2012 if at all possible.

Due Process

A8. The Exposure Draft (ED), Deferral of the Effective Date of SFFAS 38, *Accounting for Federal Oil and Gas Resources*, was released on January 5, 2011, with comments requested by February 7, 2011.

A9. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A10. This broad announcement was followed by direct e-mailings of the press release to:

a. Relevant congressional committees: Senate Committee on Energy and Natural Resources, Senate Committee on Finance, House Committee on Financial Services, and House Committee on Natural Resources;

b. Public interest groups and think tanks: Alliance to Save Energy, The Brookings Institution, The Cato Institute, Center on Budget and Policy Priorities, Citizens Against Government Waste, The Concord Coalition, The Heritage Foundation, National Parks Conservation Association (NPCA), Natural Resources Defense Council (NRDC), OMB Watch, Resources for the Future (RFF), Sierra Club, The Urban Institute, and World Resources Institute (WRI);

c. Respondents to SFFAS 38 and related EDs (or their successors);

d. Agencies that manage and / or account for federal natural resources: Department of the Interior (DOI) Office of the Secretary; DOI Bureau of Land Management ; DOI Bureau of Ocean Energy Management, Regulation and Enforcement; DOI U.S. Geological Service (USGS); Department of Agriculture (USDA), Deputy CFO; and USDA Forest Service.

A11. To encourage responses, reminder notices were provided to the FASAB email listserv on January 28, 2011, and February 8, 2011.

Comment Letters

A12. Four comment letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others	0	2
Auditors	0	0
Preparers and financial managers	2	0

A13. The Board considered responses to the exposure draft at its February 23, 2011, public meeting. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A14. Three of the four respondents were in favor of deferring the effective date. One respondent disagreed, citing the need for DOI to incorporate the reporting for oil and gas resources into its newly reorganized reporting structure as it is being developed. The Board considered both views and decided to approve the one-year deferral, noting that the additional time provided to DOI to improve upon its estimation process in light of the major reorganization of MMS would be preferable.

A15. This statement was approved for issuance by all members of the Board. Written ballots are available for public inspection at the FASAB's offices.

Appendix B: Abbreviations

BOEMRE	Bureau of Ocean Energy Management, Regulation and Enforcement
CFR	Consolidated Financial Report of the U.S. Government
DOI	Department of the Interior
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
MMS	Minerals Management Service
ONRR	Office of Natural Resources Revenue
RSI	Required Supplementary Information
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Statement of Federal Financial Accounting Standards 42: Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32

Status

Issued	April 25, 2012
Effective Date	For fiscal years beginning after September 30, 2014
Affects	• SFFAS 6, paragraphs 77-84 and Appendix C are rescinded. • SFFAS 14 is rescinded. • SFFAS 29, paragraphs 26, 28, 41, and 42 are amended. • SFFAS 32, paragraphs 12b.,12c., and 24 are rescinded. • Technical Release 9, Section III.
Affected by	None.

Summary

Deferred Maintenance and Repairs (DM&R) reporting enables the government to be accountable to citizens for the proper administration and stewardship of its assets. Specifically, DM&R reporting assists users by providing an entity's realistic estimate of DM&R amounts and the effectiveness of asset maintenance practices the entities employ in fulfilling their missions.

This Statement amends the required supplementary information (RSI) presentation requirements contained in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment* and also provides conforming amendments as explained within the Scope and Applicability section at paragraph 6. The amendments require entities to: (1) describe their maintenance and repairs (M&R) policies and how they are applied, (2) discuss how they rank and prioritize M&R activities among other activities, (3) identify factors considered in determining acceptable condition standards, (4) state whether DM&R relate solely to capitalized general property, plant and equipment (PP&E) and stewardship PP&E or also to non-capitalized or fully depreciated general PP&E, (5) identify PP&E for which management does not measure and/or report DM&R and the rationale for the exclusion of other than non-capitalized or fully depreciated general PP&E, (6) provide beginning and ending DM&R balances by category of PP&E, and (7) explain significant changes from the prior year.

Other significant amendments contained in this Statement include (1) requiring that condition standards, related assessment methods, and reporting formats be consistently applied unless management determines that changes are necessary, (2) eliminating the requirement to report condition information, and (3) eliminating the (i) optional reporting of low-high DM&R estimates as well as (ii) option to report critical and non-critical DM&R.

Additionally, the amendments note the importance of communication with, and input from, professionals in diverse disciplines in compiling and reporting DM&R information.

Table of Contents

Introduction

Purpose

1. The objective of this Statement is to improve the measurement of deferred maintenance and repairs (DM&R) by incorporating changes responsive to concerns raised by the financial and technical[1] communities. The Board also considered, where appropriate, a Government Accountability Office (GAO) study[2] specific to repair and maintenance backlog issues surrounding federal real property.

Materiality

2. 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

3. This Statement is effective for periods beginning after September 30, 2014. Earlier implementation is encouraged.

[1]This Statement uses the phrase "technical community" or "technical communities" to refer to entity personnel responsible for the management of property, plant, and equipment (PP&E), including maintenance and repair.

[2] GAO Report No. GAO-09-10 dated October 2008. *Federal Real Property. Government's Fiscal Exposure from Repair and Maintenance Backlogs is Unclear*.

Accounting Standards

Scope and Applicability

4. This Statement applies to federal entities that present general purpose federal financial reports in conformance with generally accepted accounting principles as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

5. This Statement replaces the definitions, measurement and reporting requirements for deferred maintenance and repairs established in SFFAS 6, as amended by *SFFAS 40, Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*. SFFAS 6, *Chapter 3: Deferred Maintenance and Repairs*, paragraphs 77 through 84, and *Appendix C, Deferred Maintenance and Repairs Illustration* are rescinded.

6. In addition to SFFAS 6, this Statement also provides the following conforming amendments:

   a. SFFAS 14*, Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment, and SFFAS 8, Supplementary Stewardship Reporting,* is rescinded.
   b. SFFAS 29*, Heritage Assets and Stewardship Land,* is amended to adopt the revised terminology and to rescind requirements for reporting **condition**[3] information.
   c. SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* is amended to adopt the revised terminology and to rescind certain requirements.
   d. Technical Release 9*, Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land,* Section III: Assessing and Reporting Condition is amended to explain the status of guidance relating to condition reporting.

[3] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

Definition

7. Deferred maintenance and repairs (DM&R) are maintenance and repairs that were not performed when they should have been or were scheduled to be and which are put off or delayed for a future period.

8. Maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition.[4] Activities include preventive maintenance; replacement of parts, systems,[5] or components; and other activities needed to preserve or maintain the asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.

Measurement

9. Amounts for DM&R may be measured using:

    a. condition assessment surveys,

    b. life-cycle cost forecasts, or

    c. other methods that are similar to the condition assessment survey or life-cycle costing methods.

10. *Condition assessment surveys* are periodic[6] visual (i.e., physical) inspections of property, plant and equipment (PP&E) to determine their current condition and estimated cost to correct any deficiencies.

11. *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

[4] The determination of acceptable condition may vary both between entities and among sites within the same entity. Management shall determine what level of condition is acceptable.

[5] The term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property.

[6] This Statement does not require an entity's entire portfolio to be inspected each year. It is permissible to schedule condition assessment surveys on a cyclical (i.e., calendar) basis or a frequency based on consideration of risk provided scheduling is done in accordance with established practices.

forecasts of maintenance and repairs expense, these forecasts may serve as a basis against which to compare actual maintenance and repairs expense to arrive at an estimate of deferred maintenance and repairs.

12. Management should determine which methods to apply and what condition standards are acceptable. Once determined, condition standards, related assessment methods[7], and reporting formats should be consistently applied unless management determines that changes are necessary. Although condition information is essential in developing DM&R amounts, reporting of condition information is not required. Changes to methods or formats that management determines are necessary should be accompanied by an explanation documenting the rationale for the change and any related impact on the DM&R estimate(s). To best meet the goal of DM&R reporting, communication with, and consideration of, input from professionals in diverse disciplines such as engineering, facilities management, finance, budgeting and accounting is necessary.

13. DM&R should be measured and reported for capitalized general PP&E and stewardship PP&E. DM&R also may be measured and reported for non-capitalized or fully depreciated general PP&E. DM&R should include funded maintenance and repairs (M&R) that have been delayed for a future period as well as unfunded M&R. DM&R on inactive and/or excess PP&E should be included to the extent that it is required to maintain inactive or excess PP&E in acceptable condition. For example, inactive PP&E may be maintained or repaired either to comply with existing laws and regulations, or to preserve the value of PP&E pending disposal.

Component Entity Required Supplementary Information

14. DM&R reporting should provide (1) DM&R beginning and ending balances for the reporting period and (2) narrative information related to DM&R activities. Entities are required to present both qualitative and quantitative information.

15. At a minimum, the following information should be presented as required supplementary information (RSI) for all PP&E (each category established in SFFAS 6, as amended, should be included) regardless of the measurement method chosen.

[7] Assessment methods are techniques or procedures used in a process of systematically evaluating an entity's PP&E in order to project M&R, renewal, or replacement needs that will maintain or preserve its ability to support the entity's mission or activities it is assigned to serve.

Qualitative

a. A summary of the entity's M&R policies and brief description of how they are applied; i.e., method of measuring DM&R

b. Policies for ranking and prioritizing M&R activities[8]

c. Factors the entity considers in determining acceptable condition standards

d. Whether DM&R relates solely to capitalized general PP&E and non-capitalized stewardship PP&E or also to amounts relating to non-capitalized or fully depreciated general PP&E

e. Capitalized general PP&E, and non-capitalized heritage assets and stewardship land for which management does not measure and/or report DM&R and the rationale for the exclusion

f. If applicable, explanation of any significant changes[9] to (1) the policies and factors subject to the reporting requirements established in a. through e. above and (2) DM&R amounts from the prior year[10]

Quantitative

g. Estimates of the beginning and ending balances of DM&R for each major category[11] of PP&E for which maintenance and repairs have been deferred

[8] As an example, entities may report (1) how they will pursue reducing their DM&R backlog and how they will be impacted by budget or funding shortfalls or reductions, and (2) whether or not the entity has used Return on Investment analyses in its ranking and prioritizing of either M&R or DM&R.

[9] The determination of whether or not an item is significant is a matter of professional judgment. This determination is separate and distinct from materiality considerations that include considering the likely influence that such information could have on judgments or decisions of financial statement users.

[10] Consistent with paragraph 12, once determined, condition standards and related assessment methods and reporting formats should be consistently applied.

[11] SFFAS 6 sets forth three categories of PP&E: (1) general PP&E; (2) heritage assets; and (3) stewardship land.

Consolidated Financial Report of the US Government Required Supplementary Information

16. The disclosure requirements listed in paragraphs 14 and 15 above are not applicable to the U.S. government-wide financial statements. The U.S. government-wide financial statements should include the following RSI:

    a. A description of what constitutes DM&R and how it was measured

    b. Amounts of DM&R for each major category of PP&E (i.e., general PP&E, heritage assets, and stewardship land); and

    c. A general reference to specific component entity reports for additional information

Conforming Amendments to Other Statements and Technical Releases

17. This Statement amends requirements in SFFAS 29 and 32 to replace ‘deferred maintenance’ with ‘deferred maintenance and repairs’ and to rescind certain requirements in SFFAS 29 and 32, including the requirement to report condition information. The changes to SFFAS 29 and 32 are presented in paragraphs 18 and 19 below.

18. Paragraphs 26, 28, 41 and 42 of SFFAS 29, *Heritage Assets and Stewardship Land*, are amended as follows:

    [26] ~~Entities should report the condition[11] of the heritage assets (which may be reported with the deferred maintenance information[12]) as required supplementary information.~~ Entities should include a reference to ~~the condition and~~ deferred maintenance <u>and repairs</u> information[13] ~~if~~ reported <u>in required supplementary information</u> ~~elsewhere in the report containing the basic financial statements~~.

    Paragraph 26 Footnote references:

    ~~[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] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32* for information regarding definition, measurement and required supplementary information. ~~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.~~

[28.c.] A general reference to agency reports for additional information about heritage assets, such as agency stewardship policies for heritage assets, and physical units by major categories of heritage assets~~, and the condition of the heritage assets~~.

[41] ~~Entities should report the condition[22] of the stewardship land (which may be reported with the deferred maintenance information[23]) as required supplementary information.~~ Entities should include a reference to the ~~condition and~~ deferred maintenance and repairs information[24] ~~if~~ reported in required supplementary information ~~elsewhere in the report containing the basic financial statements~~.

Paragraph 41 Footnote references:

~~[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] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32,* for information regarding definition, measurement and required supplementary information. ~~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.~~

[42. c.] A general reference to agency reports for additional information about stewardship land, such as agency stewardship policies for stewardship land, and physical units by major categories of stewardship land use~~, and the condition of the stewardship land~~.

19. Paragraphs 12b., 12c., and 24 of *SFFAS 32: Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 “Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government” are rescinded.*

~~12. b. The text “The above listed required supplementary information is not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for required supplementary information applicable to the U.S. government-wide financial statements for these activities.” is added as a separate bullet following the existing text for par. 83.~~

~~12. c. The text “The U.S. government-wide financial statements need not separately report stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition as well as management’s definition of these categories. SFFAS 32 provides for optional information applicable to the U.S. government-~~

~~wide financial statements for these activities." is added to par. 84 as the final sentences.~~

~~24. The U.S. government-wide financial statements should include the following required supplementary information:~~

~~a. a broad description of deferred maintenance,~~

~~b. amounts or ranges of amounts of deferred maintenance for each major asset category (i.e., general property, plant, and equipment; heritage assets, and stewardship land) for which maintenance has been deferred,~~

~~c. a general reference to component entity reports, and~~

~~d. optional reporting of the stratification between critical and non-critical amounts of maintenance needed to return each major asset category to its acceptable operating condition.~~

20. This Statement amends requirements in Technical Release 9, Section III, to acknowledge the rescission of requirements to report condition information as RSI. The following text is to be inserted before Section III:

    Statement of Federal Financial Accounting Standards 42, *Deferred Maintenance and Repairs*, *Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32,* rescinded the requirement to report condition information regarding heritage assets and stewardship land as RSI. The following guidance offers insights regarding condition assessments and factors that may influence reporting of deferred maintenance and repairs information. The guidance has not been updated to conform to the new standards and should be considered other literature until revised implementation guidance, if any is provided.

Effective Date

21. This Statement is effective for periods beginning after September 30, 2014. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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 provided in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. Concerns pertaining to DM&R reporting have arisen since the issuance of SFFAS 6. The two most common concerns related to (1) the lack of comparability in assessing asset condition both within and among entities and (2) measurement and reporting practices and formats that vary greatly among entities. In its most recent real property study (GAO Report No. GAO-09-10 dated October 2008), the GAO noted that entities define and estimate DM&R differently in part due to the degree of flexibility afforded by both SFFAS 6 and the Federal Real Property Profile Reporting Guidelines. As a result, confusion and uncertainty exists among users of DM&R information.

A2. Primarily as a result of auditor concerns, SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, amended SFFAS 6 and SFFAS 8 to reclassify deferred maintenance information as required supplementary information instead of a disclosure in the notes to the financial statements.

A3. At the time, the Board believed that a period of experimentation would be desirable for deferred maintenance information and that classifying it as RSI was appropriate during the experimentation period. As a result, the standards for estimating deferred maintenance were intentionally flexible. However, at a minimum, the Board expected to develop guidance on determining acceptable condition and revise the standards based on experience gained during the experimentation period.

A4. Since completing deliberations on SFFAS 40, *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards*

6, Accounting for Property, Plant, and Equipment, the Board has continued seeking advice and guidance from stakeholders interested in improving the management of, and reporting on, federal PP&E and related DM&R.

A5. As demonstrated by SFFAS 40, the Board has spent considerable time and effort working with key stakeholders and the community-at-large evaluating much of the experience gained during the experimentation period. As a result, the Board has both reaffirmed and refined its position regarding DM&R measurement and reporting.

A6. Two external reports served as the initial basis for the scope of the Task Force's work.[12] The first report (Deferred Maintenance Reporting for Federal Facilities, The National Academies, (2001), ISBN 0-309-56339-9) was a critique of the deferred maintenance definition in SFFAS 6*, Accounting for Property, Plant, and Equipment*. This report was prepared by the Federal Facilities Council under the auspices of The National Academies. The report was reviewed by the Task Force and provided a foundation for the proposed amendment(s) contained in SFFAS 40. The second report (GAO Report No. GAO-09-10 dated October 2008) was a GAO study specific to federal real property repair and maintenance backlog issues. In that study, the GAO discussed the need for comparability and realistic estimates of deferred maintenance so that the government's fiscal exposure could be revealed.

A7. The Task Force's work was not constrained by either of these external reports. Task Force members contributed entity specific information which also included input from internal and external audit communities.

Summary of Outreach Efforts

A8. The Exposure Draft was issued June 27, 2011 with comments requested by September 16, 2011. Upon release of the exposure draft, notices and press releases went to *The Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency (CIGIE), the Financial Statement Audit Network; members of both the Federal Real Property Council and the Federal Facilities Council and committees of professional associations generally commenting on exposure drafts in the past.

[12] During 2008 FASAB established a Task Force to address deferred maintenance and asset impairment issues. The Task Force consists of government and non-government representatives from various disciplines such as: real property/facilities management, personal property management, appraisal and valuation services, engineering, architecture, accounting, internal auditing, external auditing, finance, and budgeting.

Responses to the Exposure Draft

A9. Twenty-two responses were received. Table 1.0 summarizes responses by respondent type.

Table 1.0

Summary of Respondents by Type to Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	11	0	11
Users, academics, others	5	3	8
Auditors	3	0	3
Total	19	3	22

A10. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

No Longer Requiring Condition Reporting - Refining the Goal of DM&R

A11. The majority of respondents agreed with the Board's proposal to no longer require condition reporting. Respondents who disagreed noted that (1) condition reporting for key infrastructure which directly affects public safety provides a measure of the effectiveness of the allocated budget to maintain those critical assets, (2) condition reporting has become the "standard" to understand the overall condition of facilities, and (3) all federal agencies are required to report condition information and DM&R by the Federal Real Property Council Reporting Requirements.

A12. The goal of DM&R is to provide reliable information on the estimated cost of the PP&E maintenance and repairs that have been deferred. To that end, this Statement no longer requires that condition information be reported. Although condition reporting is important and is the basis of an entity's DM&R estimate, the Board determined that it is not an essential component of financial reports. The Board's rationale for this decision is that condition assessment methods and reporting continue to evolve and there are no federal-wide uniform assessment or measurement methods that would increase comparability and understandability. Therefore, summarized condition information may not provide meaningful information to users. The Board believes the wide variation among entities in condition assessment methods and reporting (i.e., different condition ratings/rankings) could obscure user understanding of the government's fiscal exposure (realistic DM&R estimate). The Board believes that this is an area where entity administrative burden can be alleviated given the questionable benefits of summarized condition information.

A13. This Statement eliminates the requirement to report condition information. However, entities may include condition information in a manner they believe best presents and contextualizes DM&R and related performance matters.

Presenting Beginning and Ending DM&R Balances and Explanation of Significant Changes

A14. The majority of respondents agreed with the Board's proposal to require that entities present beginning and ending DM&R balances and explain significant changes. Respondents who disagreed noted that because many variables impact the change in DM&R estimates a significant change could result in wide disparities among the component entities.

A15. The Board believes that presenting DM&R balances and discussing significant changes increases comparability while also enhancing entity-specific consistency. Some respondents have noted that discussing significant changes is not only reasonable, but required inasmuch as it is a part of determining the underlying causes to such changes. As one respondent noted, discussing changes is essential for transparency and accountability.

A16. The Board believes that users need to know how much the M&R requirements increased (decreased) in dollar terms and the effect of this change on the DM&R balances. Moreover, it is important for users to (1) understand the events that occurred during the year and why they brought about significant increases or decreases and (2) whether or not DM&R levels have changed (e.g., the amount declined). To that end, federal entities are required to present their DM&R beginning and ending balances. As illustrated in Appendix B, entities should present these balances by category (i.e., general PP&E, heritage assets, and stewardship land), and explain significant changes by major asset category. The determination of whether an item is significant is a matter of professional judgment. This determination is separate and distinct from materiality considerations. Factors that might be considered when determining whether an item is significant include the: (1) absolute dollar amount of the change in DM&R estimates, (2) percent change in DM&R estimates, (3) perceived importance of the reason for the change to financial statement users, and (4) potential consequences arising from the change (e.g., effect on mission). The Board believes that this will increase comparability and the relevance and reliability of the DM&R estimates and will significantly enhance entity-specific consistency from year to year.

Applying Reported Methods and Reporting Formats Consistently using an Interdisciplinary and Integrated approach

A17. The majority of respondents agreed with the Board's proposal to require that entities apply reported methods and reporting formats consistently unless management determines that changes are necessary and if changes to methods or formats are necessary, such changes should be explained. Furthermore, respondents agreed that input from professionals in diverse disciplines is necessary to effectively compile and report DM&R.

A18. Because consistency in measurement and reporting significantly adds to the informational value of DM&R estimates (i.e., trend information is useful to decision makers), management must use consistent assessment techniques, measurement methods and reporting formats from year-to-year. However, if management decides to change methods or formats, such changes should be accompanied by an explanation documenting the rationale for the change and any related impact to the DM&R estimate(s). This is consistent with Task Force concerns that (1) entities be allowed to adopt new and improved methods or technologies that might be brought about in the area of asset management and (2) greater rigor and discipline is needed in the area of DM&R measurement and reporting.

A19. Staff research found that some agencies have interpreted SFFAS 6 requirements to apply only to unfunded DM&R activities.[13] As a result, inaccurate reporting and increased lack of consistency and comparability has resulted. The Board notes whether funded or not, DM&R should be reported. For example, if funding exists but competing demands cause a schedule slippage and result in a delay to a future period, such costs should be reported as DM&R.

A20. Staff research also found that some entities have not reported DM&R because they have not distinguished between needed capital improvements (e.g., activities which extend the useful life of PP&E) and needed repairs (e.g., activities which allow PP&E to attain its original useful life). SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles,*

[13] Department of Defense Inspector General Report dated September 25, 2009, *Deferred Maintenance on the Air Force C-130 Aircraft* (Report No. D-2009-112.)

Including the Application of Standards Issued by the Financial Accounting Standards Board, states that "[g]enerally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. Consideration should be given to whether the substance of transactions or events differs materially from their form."[14] For DM&R amounts to be comparable, entities must consider the substance rather than the form—that is, the terms applied by management—of future activities relating to PP&E.

A21. An interdisciplinary and integrated approach is necessary to address completeness and consistency and meet the goal of DM&R reporting. This includes communicating among and considering input from experts in diverse disciplines such as engineering, facilities management, finance, budgeting, and accounting. Such input should be considered when determining acceptable condition and related costs to remedy assets. Such an approach will help to (1) ensure the increased value and efficacy of the reported information, (2) meet diverse user needs, and (3) foster system integration and process improvements via continual interaction among entity staff.

Narrative Information Describing M&R Policies and other Non-financial Information

A22. The majority of respondents agreed with the Board's proposal to require that entities provide narrative information describing M&R policies and other non-financial information including any significant changes to policies and other factors from the prior year. Respondents who disagreed noted that combining policy statements across a reporting entity with heterogeneous assets and varying missions is difficult.

A23. The Board believes that users need to understand how entities carry-out their stewardship responsibilities. Moreover, many entities maintain such information as part of their overall management and stewardship responsibilities.

A24. Although flexibility is necessary in the areas of determining asset condition and defining acceptable condition, the Board believes that additional disclosures are required in order to increase consistency, comparability, and the reliability and relevance of DM&R estimates. Consequently, the Board believes that:

a. disclosing M&R policies and how they are applied in practice assists users in understanding how an entity manages its DM&R.

b. disclosing policies for ranking and prioritizing M&R activities assists users in understanding how an entity efficiently and effectively manages its M&R resources. As

[14] SFFAS 34, footnote 5.

such, preparers may provide general context in their explanations concerning the amount of the ending balance that the entity would need to incur in the near-term to avoid adverse impact to the entity's mission. Additionally, the Board believes that in order to enhance the relevance and reliability of the entity's estimated DM&R amount, an entity should explain how it decides to allocate its (available) resources. For example, entities frequently give top priority to maintenance and repair activities that maintain employee or constituent health and safety or are required to satisfy regulatory mandates. Once this is accomplished, entity rankings may be adjusted for asset condition assessments, and management considerations that include: capital improvement plans, asset disposal plans, and budgetary funding outlook.

c. identifying factors the entity considers in selecting acceptable condition standards assists users in understanding the unique nature of the entity's mission and operating environment and how these affect asset management. Regardless of whether entities report condition information, the underlying rationale an entity uses in making this managerial judgment enhances the relevance and reliability of the entity's estimated DM&R. For example, an entity might set different acceptable condition standards for identical assets because of geographical or environmental factors specific to each.

d. disclosing whether DM&R relates solely to capitalized general PP&E and non-capitalized stewardship PP&E or also includes amounts relating to non-capitalized or fully depreciated general PP&E assists users in understanding how an entity manages its DM&R. Partially as a result of increased emphasis in the reporting of real property information, it has come to the Board's attention that some entities, in addition to tracking DM&R on capitalized general and non-capitalized stewardship PP&E, also track and report DM&R on expensed or fully depreciated general PP&E; i.e., all accountable PP&E.

e. identifying PP&E for which management does not measure and/or report DM&R and the rationale for the exclusion assists users in understanding how an entity efficiently and effectively manages its M&R resources. Management should clearly disclose and provide a rationale for this exclusion. For example, PP&E designated as excess and subject to disposal or considered unserviceable may not have any associated DM&R.

Eliminating Dollar Ranges and Critical / Non-critical Designations

A25. The majority of respondents agreed with the Board's proposal to eliminate dollar ranges and critical / non-critical designations. However, a respondent noted that the intent of distinguishing critical from non-critical DM&R was to provide insight into the timing of such expenditures. As such, the respondent asked the Board to consider an alternative to providing information concerning the ending balance that the entity would need to achieve in the near term in order to avoid adverse impact to the entity's mission.

A26. The Board notes that requiring DM&R designations would be (1) overly prescriptive and difficult for agencies to calculate, (2) inconsistent with Board actions to-date that acknowledge the imprecise nature of DM&R estimates and (3) contrary to the goal of focusing on a singular DM&R estimate. However, the Board does believe that this may be beneficial information that preparers could consider providing.

A27. The stratification between critical and non-critical DM&R at SFFAS 6, paragraph 84 was intended to be optional and not an unnecessary burden to entities. It has come to the Board's attention that the Federal Real Property Guidelines define "critical" at the asset level (i.e., asset classification defines if M&R is critical or not) whereas the SFFAS 6 guidelines have been interpreted to apply to the discrete M&R activity (i.e., the nature of the work defines if M&R is critical or not). Furthermore, some entities are following Treasury guidelines which define "critical" as a matter of consequence or exigency (i.e., impact of not performing the M&R work/activity).[15] Consistent with the Task Force's recommendation, it is the Board's opinion that having three separate definitions for "critical" has led to confusion, increased lack of comparability, and estimates that are not necessarily reflective of what entities expect to incur. The Board believes that the reporting of critical and non-critical DM&R is not useful, can lead to inconsistency, and therefore should be not be addressed in the Statement.

Other Matters

Active and Inactive PP&E

A28. Measuring DM&R related to active and inactive PP&E helps ensure that DM&R estimates capture reliable information on the estimated cost of the PP&E maintenance and repairs that have been deferred. For example, entities are often required by law or regulation to obtain approval(s) prior to disposing real property deemed inactive or excess. If entities continue to measure DM&R on PP&E pending disposition, DM&R estimates may be overstated because M&R having a low probability of occurrence may be included. As a result, DM&R that is not expected to be incurred due to an asset's inactive status may be separately identified in order to provide for a more realistic DM&R estimate, if deemed material.

[15] June 17, 2010, Appendix 4 of Chapter 4700 in Vol. 1 of the Treasury Financial Manual, Other Financial Report (FR) Notes Data and Instructions. *"Critical deferred maintenance is urgently needed, absolutely necessary, and is an element that needs immediate attention. Furthermore, critical deferred maintenance is any deferred maintenance that poses a serious threat to the public or employee safety or health, natural or cultural resources, and a bureau's ability to carry out its assigned mission."*

Assessment Method Factors and Selection Criteria

A29. In measuring DM&R, entities are free to choose among assessment methods described in this Statement. For example, an entity may elect to use a life-cycle method to assess its PP&E as part of its overall project management strategy to enhance its ability to predict future maintenance and repair requirements. Another entity may elect to use a parametric method[16] due to the size and complexity of its portfolio and to realize efficiencies and cost savings while another entity requiring asset-specific condition information may select the condition assessment survey method. The Board realizes that entities need to consider many factors when selecting assessment methods. Such factors could include:

a. nature, size and complexity of the PP&E portfolio,

b. mission requirements,

c. cost versus benefit,

d. changes in economic outlook,

e. project management strategy,

f. nature or type of asset to be inspected,

g. asset-specific condition assessment requirements,

h. environmental or weather conditions,

i. availability of commercial-off-the-shelf (COTS) software,

j. availability of government-off-the-shelf (GOTS) software,

k. software scalability and related vendor support,

l. regulatory requirements, and

m. health and safety considerations.

[16] Similar to the life-cycle costing method, the parametric method is an accepted technique that entails performing condition assessments at the system level rather than the component level.

A30. In order to obtain greater consistency and comparability this Statement provides that once selected, condition standards, related assessment methods and reporting formats should be consistently applied unless management determines that changes are necessary. General selection criteria management could use in evaluating different assessment methods include the following:

CONDITION ASSESSMENT SURVEYS (i.e., visual, physical inspections)

PROS

- Generates DM&R estimates
- More timely identification of health and safety issues
- Usually identifies and prioritizes work items / specific repairs
- Modified surveys are affordable
- Knowledge-based surveys (e.g., risk management strategies) eliminate over - and under-inspection
- Engineered-based surveys provide consistent and credible results

CONS

- Traditional surveys are expensive
- Does not always identify or prioritize work items / specific repairs
- Wasteful over-inspection, risky under-inspection
- Inspector bias could distort results

LIFE CYCLE COSTING METHODS (i.e., modeling)

PROS

- Generates DM&R estimates
- Affordable
- Efficient
- Focuses on buildings and systems
- Facilitates evaluation of large portfolios

CONS

- Determining the cumulative costs of deferring maintenance
- Does not identify or prioritize work items / specific repairs
- Not always appropriate for smaller portfolios
- Could require expensive updating of initial procurement information
- Credibility issues

Board Approval

A31. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Sample Illustration

Appendix B
Deferred Maintenance and Repairs Illustration

This appendix illustrates the requirements at paragraphs 14 and 15. The examples shown here are for illustrative purposes only. Different entities may develop different asset classes and descriptive terminology consistent with the set categories of general PP&E, heritage assets, and stewardship land. The following narrative discussion and Illustration #1, *General Purpose Display* meet the minimum requirements of this Standard. <u>The various illustrations are not meant to articulate with one another and should be viewed on a stand-alone basis.</u>

XYZ Entity
Deferred Maintenance and Repairs for Fiscal Year 20x2

The XYZ entity operates over 1,300 facilities throughout the world, preserves nearly 300 national historical landmarks of natural, cultural, educational, or artistic importance, and is responsible for maintaining over 80,000 acres of stewardship land. Most of the facilities are predominantly used for office space and warehousing defense assets. Additionally, the entity operates a hospital at one of its remote sites. It is entity policy to ensure that medical equipment and critical equipment systems are maintained and managed in a safe and effective manner. Therefore, deferred maintenance and repairs do not arise for these two types of equipment and no periodic assessment is performed. Additionally, since (1) it is entity policy to maintain and preserve all fixed property, plant and equipment (PP&E) regardless of recorded values and (2) accounting and asset management systems do not differentiate M&R between PP&E capitalized (i.e., items whose cost exceeds the capitalization threshold) versus those expensed, DM&R estimates reported herein relate to all PP&E whether capitalized or not or fully depreciated.

Defining and Implementing M&R Policies in Practice.

As permitted under SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*, the entity employs a parametric estimating method for the largest portion of its portfolio (real property such as office and warehouse space) and the condition assessment method for its hospital facility, defense and stewardship assets. With the exception of the hospital facility which is inspected on a yearly basis, the entity's real property portfolio is assessed on a 3 to 5 year rotating calendar. Both methods measure current real property asset condition and document real property deterioration.

Real property assessment methods produce both a cost estimate of deferred maintenance and repairs, and a Facility Condition Index (FCI). Both measures are indicators of the overall condition of the entity's facilities. The parametric estimating methodology involves an independent, rapid visual assessment of nine different systems within each facility to include: structure, roof, exterior, interior finishes, HVAC (heating, ventilation, and air conditioning), electrical, plumbing, conveyance, and program support equipment. The parametric estimating method is designed to be cost-effective and appropriate for application to a large population of facilities; results are not necessarily applicable for individual facilities or small populations of facilities.

The entity's hospital is inspected on a yearly basis employing a physical inspection method which focuses on component as well as system distresses in addition to identifying deficiencies. The entity's defense assets are routinely surveyed by unit and depot maintenance personnel and stewardship assets are routinely surveyed by on-site personnel and regional inspection teams.

As stated above, it is entity policy to ensure that medical equipment and critical facility equipment systems are maintained and managed in a safe and effective manner. Therefore, deferred maintenance and repairs assessment methods are generally not applied to equipment assigned to hospitals as any DM&R would be negligible.

Ranking and Prioritizing M&R Activities.

Maintenance and repair activities are first prioritized via health, safety and regulatory considerations at all facilities. Once this is accomplished, the FCI values are then ranked based on the ratings obtained during the condition assessment site visits. Rankings are generally adjusted to take into account current capital improvement efforts underway, future capital improvement plans, asset disposal plans, and budgetary funding outlook.

Factors Considered in Setting Acceptable Condition.

For office and warehouse space, the entity defines acceptable condition in accordance with standards comparable to those used in private industry. For example, industry standards for administrative buildings can vary substantially depending upon their classification as either a Class A, B, or C property. Such classifications are affected by building location, design, and age. Condition standards for warehouses are primarily set by local jurisdictions and consider factors such as accommodating loads, materials to be stored, the associated handling equipment, the receiving and shipping operations, associated trucking, and the needs of the operating personnel. Acceptable condition for the hospital facility is in accordance with federal statutory requirements and requirements adopted by the health care facilities industry substantially comparable to the requirements at 42 C.F.R. Part 483 entitled, *Requirements for States and Long Term Care Facilities*.

Military specifications and standards for defense assets vary greatly depending upon numerous factors such as the nature and type of equipment and mission expectations. Acceptable condition standards for defense assets are set at levels deemed to be mission capable or serviceable. Heritage assets and stewardship land adopt scientific conservation standards to preserve assets in a manner that fulfills the entity's obligation to stabilize, protect, and preserve the assets.

Significant Changes from Prior Year and Related Events.

The overall net increase of $2.0 billion in DM&R is a result of the $3.0 billion increase in General PP&E DM&R, offset by a $1.0 billion decrease in heritage assets DM&R.

Funded DM&R decreased by $1.0 billion as result of the entity's strategic initiative to repair and restore many of its historical landmarks. However, unfunded DM&R pertaining to inactive/excess general PP&E increased by $3.0 billion as a result of (1) the transfer of properties from other federal entities, (2) newly identified properties and equipment no longer needed by the entity, and (3) continued degradation of properties awaiting final disposition. Management policy is to comply with legal requirements to maintain inactive/excess property in safe condition and to pursue cost-beneficial measures to preserve the value of properties. The entity in collaboration with other entities and members of Congress is in the process of finalizing plans to either dispose of or find alternate uses for the aforementioned properties. For such properties, DM&R include those M&R activities management believes are warranted but not necessarily the M&R appropriate for an equivalent active property.

The following illustration presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs and meets the basic illustration requirements of this Standard:

ILLUSTRATION 1 - GENERAL PURPOSE DISPLAY

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	**20x2 Ending Balance DM&R**	**20x2 Beginning Balance DM&R**
General PP&E	$33,500	$30,500
Heritage Assets	5,000	6,000
Stewardship Land	2,500	2,500
Total	$41,000	$39,000

The following Illustration # 2 presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs with an emphasis on active versus inactive/excess assets:

ILLUSTRATION 2 - EMPHASIS ON ACTIVE vs. INACTIVE and EXCESS

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	**20x2 Ending Balance DM&R**	**20x2 Beginning Balance DM&R**
Active:		
General PP&E	$46,875	$45,000
Heritage Assets	0	1,500
Stewardship Land	1,500	1,500
subtotal -active	48,375	48,000
Inactive and Excess:		
General PP&E	13,125	10,500
subtotal –general PP&E – inactive and excess	13,125	10,500
Total	**$61,500**	**$58,500**

The following Illustration # 3 presents information on major asset classes experiencing material amounts of deferred maintenance and repairs with an emphasis on active versus inactive/excess assets:

ILLUSTRATION 3 - EMPHASIS ON ACTIVE vs. INACTIVE and EXCESS BY ASSET CLASS

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category / Class	**20x2 Ending Balance DM&R**	**20x2 Beginning Balance DM&R**
Active:		
General PP&E:		
Structures	$14,375	$14,000
Aircraft	53	5
Missiles	139	58
Ships	1,058	937
subtotal - general PP&E active	15,625	15,000
Stewardship Land	500	500
Heritage Assets	0	500
subtotal - all active	16,125	16,000
Inactive and Excess:		
General PP&E		
Buildings	2,500	2,500
Structures	1,875	1,000
subtotal - general PP&E - inactive and excess	4,375	3,500
Total	**$20,500**	**$19,500**

The following Illustration # 4 presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs with an emphasis on funded and unfunded maintenance and repairs:

ILLUSTRATION 4 - EMPHASIS ON FUNDED and UNFUNDED M&R

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	**20x2 Ending Balance DM&R**	**20x2 Beginning Balance DM&R**
Funded M&R:		
General PP&E -active	$26,500	$30,000
General PP&E - inactive and excess	19,500	16,000
Heritage Assets	0	2,000
Subtotal - funded	46,000	48,000
Unfunded M&R:		
General PP&E -active	15,000	15,000
General PP&E - inactive and excess	6,000	0
Heritage Assets	10,000	10,000
Stewardship Land	5,000	5,000
Subtotal - unfunded	36,000	30,000
Total	$82,000	$78,000

Appendix C: Abbreviations

DM&R	deferred maintenance and repairs
FASAB	Federal Accounting Standards Advisory Board
FCI	Facility Condition Index
FRPP	Federal Real Property Profile (GSA Asset Management Database)
GAO	Government Accountability Office
G-PP&E	general property, plant and equipment
M&R	maintenance and repair(s)
OMB	Office of Management and Budget
PP&E	property, plant, and equipment
RSI	required supplementary information
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Deferred Maintenance and Asset Impairment (DM-AI) Task Force Members

U. S. Agencies

Department of Agriculture, U.S. Forest Service

Department of Commerce, National Oceanographic and Atmospheric Administration

Department of Defense, Office of the Secretary of Defense

Department of Defense, Acquisition, Technology, and Logistics

Department of Defense, Comptroller

Department of Energy, Office of Engineering and Construction Management

Department of Interior

Department of Labor, Office of the Inspector General

Department of State

Department of State, U.S. Agency for International Development

Department of State, International Boundary and Water Commission

Department of the Treasury, Financial Management Service

Department of Veterans Affairs

General Services Administration

General Services Administration, Public Buildings Service Central Office

National Aeronautics and Space Administration

Office of Management and Budget

Smithsonian Institution

Task Force Member Firms

American Institutes for Research

Duller Studios

Federal Facilities Council, Committee on Sustainable Operations and Maintenance

Institute for Responsible Infrastructure Stewardship

KPMG LLP

Navigant Capital Advisors

Statement of Federal Financial Accounting Standards 43: Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Earmarked Funds

Status

Issued	June 1, 2012
Effective Date	For fiscal years beginning after September 30, 2012
Affects	SFFAS 27 Accounting Standards section (paragraphs 11-39)
Affected by	None.

Summary

This Statement amends Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds*, by:

- changing the term "earmarked funds" to "funds from dedicated collections."
- modifying the definition of a fund from dedicated collections by:
    - clarifying that at least one source of funds external to the federal government must exist for a fund to qualify as a fund from dedicated collections, and
    - adding an explicit exclusion for any fund established to account for pensions, other retirement benefits, other postemployment or other benefits provided for federal employees (civilian and military).
- permitting either consolidated or combined data on funds from dedicated collections to be provided.
- permitting certain component entities to report on funds from dedicated collections for amounts related to the statement of changes in net position in a note rather than on the face of the statement.
- illustrating optional formats for displaying information on the face of the balance sheet and statement of changes in net position.

Table of Contents

Introduction

Purpose

1. The Board evaluated Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, which has been in effect since fiscal year (FY) 2006, and identified areas for improvement. The review found some aspects of the requirements that should be clarified and identified challenges inherent in presenting understandable information that meets the reporting objectives of SFFAS 27. This Statement amends the requirements to resolve these matters.

Materiality

2. 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.

Accounting Standard

Applicability and Scope

3. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

4. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*.

Amendments

New Term for "Earmarked Funds"

5. The title of SFFAS 27 is amended as follows: SFFAS 27, *Identifying and Reporting Funds from ~~Earmarked Funds~~* ***Dedicated Collections.***[1]

6. The term "earmarked funds" is changed to "funds from dedicated collections" in the accounting standards of SFFAS 27 and conforming grammatical changes are made throughout SFFAS 27.[2] Paragraphs amended for terminology are: 11 – 18, 20 – 24, 26 – 34, and 39. The entire text as amended is presented in Appendix B.

Definition of Funds from Dedicated Collections

7. SFFAS 27, paragraph 11 is amended as follows:

   [11]~~Earmarked funds~~ ~~F~~ Generally, funds from dedicated collections are financed by specifically identified revenues,[3a] provided to the government by non-federal sources, 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 a~~n~~ ~~earmarked~~ fund from dedicated collections are:

   1. A statute committing the federal government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source[3b] only for designated activities, benefits or purposes;

   2. Explicit authority for the ~~earmarked~~ fund to retain revenues and/or 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[4] on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the ~~earmarked~~ fund from the federal government's general revenues.

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[2] For example, in places the adjective "earmarked" has been changed to "such" funds, for example in paragraph 24 of SFFAS 27.

Footnote 3a: Such specifically identified revenue can be either exchange or nonexchange.

Footnote 3b: In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

Footnote 4: A "report" may be something other than stand-alone financial statements for the ~~earmarked~~ fund from dedicated collections.

Predominant Source of Funds

8. To distinguish the definition from explanatory text relating to its application, a new subheading – "Application of the Definition" – is inserted in SFFAS 27 before paragraph 12.

9. SFFAS 27, paragraph 13 is amended as follows:

[13] **Fund** in this Statement's definition of ~~earmarked~~ funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related 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] Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:

1. its predominant sources of revenue and other financing sources are non-federal sources meeting the paragraph 11.1 criterion, or

2. it has non-federal sources of revenue and other financing sources meeting the paragraph 11.1 criterion[5a] that are material to the reporting entity.

For example, as currently funded, Medicare Parts B and D do not have non-federal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.

Footnote 5: National Council on Governmental Accounting Statement 1, par. 16.

<u>Footnote 5a: In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:</u>

<u>1. long-term expectations rather than periodic results that may fluctuate</u>

<u>2. 36-month averages</u>

<u>Changes in classification of funds from year to year should be disclosed.</u>

10. SFFAS 27, paragraph 14 is amended as follows:

[14] Whereas ~~earmarked~~ funds <u>from dedicated collections</u> are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not ~~earmarked~~ <u>dedicated</u> by law for a specific purpose and by 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 <u>from dedicated collections</u> reflects a longer (if not indefinite) government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. ~~Earmarked f~~Funds <u>from dedicated collections</u> may ~~have~~ <u>be given authority to make expenditures by means of</u> 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~~ <u>budget authority</u> is provided by authorizing legislation or annual appropriations acts, the ~~cumulative results of operations earmarked~~ funds ~~is~~ <u>are</u> reserved or restricted to the designated activity, benefit or purpose.

Funds Excluded

11. SFFAS 27, paragraph 18 is amended as follows:

[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. <u>Funds established to account for pensions, other retirement benefits, other</u>

postemployment benefits, and other employee benefits provided to federal employees (civilian or military) should not be classified as funds from dedicated collections because such funds account for employer-employee transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 56-96.[6a] In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that the large negative net position of these funds obscures the large cumulative amount that needs to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes.

Footnote 6a: Because classification and reporting should be made at the level of an individual fund, portions of funds, such as the Federal Employees Compensation Account portion of the Unemployment Trust Fund, should not be excluded because of this provision.

Component Entity: Disclosures and Eliminations

12. SFFAS 27, paragraphs 19 and 20 through 24 and paragraph 26 and related headings are amended as follows:

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 t~~The portion of cumulative results of operations and unexpended appropriations attributable to ~~earmarked~~ funds from dedicated collections should be shown separately on ~~both the statement of changes in net position and~~ the balance sheet. This standard does not require ~~earmarked~~ funds from dedicated collections to be separately shown on the statement of net cost. Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the statement of changes in net position if:

1. dedicated collections are the predominant source of revenue and other financing sources for the **component entity**, or

2. one or more of the entity's funds from dedicated collections

a. is of immediate concern to constituents of the fund,

b. is politically sensitive or controversial,

c. is accumulating large balances, or

d. the information provided in the financial statements would be a primary source of financial information for the public

For example, the Social Security and Medicare programs are of immediate concern to their constituents; both programs have a direct current or future impact on the majority of the general public.

[19a] Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. ~~(See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)~~

[19b] Component entities that do not separately show amounts from dedicated collections on the statement of changes in net position should refer on the face of the statement of changes in net position to the note on funds from dedicated collections.

[20] Most ~~earmarked~~ revenues and other financing sources that are dedicated collections are reported 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~~ revenues and other financing sources that are dedicated collections, 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]

Footnote 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.

Disclosure

[21] A component entity should disclose[8] all ~~earmarked~~ funds from dedicated collections for which it has program management responsibility by either a list~~,~~ (by official title~~,~~) or a statement indicating where the ~~information~~ list can be obtained (e.g., a website reference or

contact information). A~~n earmarked~~ fund from dedicated collections 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.)

Footnote 8: Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

[22] ~~The following~~ Information should be disclosed for each individual ~~earmarked~~ fund~~s~~ from dedicated collections. An exception is provided for component entities having numerous individual ~~earmarked~~ funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual ~~earmarked~~ funds from dedicated collections, ~~and~~ in aggregate for all remaining ~~earmarked~~ funds from dedicated collections, and in total for all the entity’s ~~earmarked~~ funds from dedicated collections:

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 providing gross cost, exchange revenue, net cost of operations, nonexchange revenues by major type and all other, other financing sources by major type and all other, and change in net position.

Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. The information required by this paragraph ~~for earmarked funds~~ may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. The information must be in sufficient detail to support reporting requirements for the U.S. government-wide financial statements in paragraphs 29 and 30. 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~~ net position shown in the note disclosure should agree with the ~~cumulative results of operations~~ total net position for ~~earmarked~~ funds from dedicated collections shown on the face of the component entity’s ~~basic financial statements~~ balance sheet.[9] ~~(See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)~~

~~Footnote 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.~~

Footnote 9 was rescinded by SFFAS 43, *Revisions to Identifying and Reporting Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27*

[23] The following information should be disclosed for each individually reported ~~earmarked~~ fund from dedicated collections, 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 from dedicated collections to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

a. quantitative factors such as

1. the percentage of the reporting entity's ~~earmarked~~ revenues from dedicated collections or

2. cumulative results of operations from ~~earmarked~~ such funds; and

b. qualitative factors such as

1. whether a~~n~~ ~~earmarked~~ fund from dedicated collections is of immediate concern to constituents of the fund,

2. whether it is politically sensitive or controversial,

3. whether it is accumulating large balances, or

4. whether the information provided in the financial statements would be the primary source of financial information for the public.

[25] The total ~~cumulative results of operations~~ net position of all ~~earmarked~~ funds from dedicated collections shown in the note disclosure should agree with the ~~cumulative results of operations~~ net position of ~~earmarked~~ funds from dedicated collections 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 20 or footnote 5a of paragraph 13, if a component entity reports a different portion of a~~n~~ ~~earmarked fund~~ program funded by dedicated collections 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 a~~n~~ ~~earmarked~~ fund from dedicated collections, ~~or portion thereof,~~ that it reported in the previous year. It also applies if a component entity ~~does~~ reports a~~n~~ ~~earmarked~~ fund from dedicated collections~~, or portion thereof,~~ that it did not report in the previous year.

Financial Statements and Disclosures for the U.S. Government-wide Financial Statements

13. Requirements for the U.S. Government-wide Financial Statements are amended as follows:

[30] Specific information should be disclosed for selected ~~earmarked~~ funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual ~~earmarked~~ funds from dedicated collections ~~and~~, in aggregate for all remaining ~~earmarked~~ funds from dedicated collections, and in total for all funds from dedicated collections ~~with 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.

The disclosure may present combined or consolidated amounts and the presentation must be labeled accordingly.

Updates for Subsequent Issuances

14. Footnote 6 of SFFAS 27, which refers to the exposure draft for SFFAS 31, is updated to refer to SFFAS 31.

15. Paragraph 37 of SFFAS 27 is updated as follows:

[Paragraph 37 was superseded by paragraph 34 of SFFAS 31, which rescinded paragraphs 83 through 87 of SFFAS 7.]

Implementation Guidance

16. In the year this standard becomes effective, entities should restate prior period amounts displayed on the face of the financial statements and disclosed in notes.

Effective Date

17. This Statement is effective for periods beginning after September 30, 2012. Early adoption is not permitted.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Note: This Statement changes the term "earmarked funds" to "funds from dedicated collections." Conforming changes have been made for clarity and grammar.

Project Background

A1. SFFAS 27 was established to distinguish between funds from dedicated collections and all other funds. Funds from dedicated collections have characteristics that justify special accountability. An explicit commitment associated with the statutory establishment of such funds is created that raises an expectation on the part of the public that the government will use the amounts collected from specific sources and accumulated in funds from dedicated collections for their stated purpose. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined.

A2. SFFAS 27 became effective in fiscal year 2006. It required each component entity to display nonexchange revenue and other financing sources, and net cost of operations[3] attributed to funds from dedicated collections and all other funds separately on the statement of changes in net position. The component entity also displays the portions of cumulative results of operations and unexpended appropriations attributable to funds from dedicated collections and all other funds separately on the statement of changes in net position and on the balance sheet. The government-wide financial statements display revenue, other financing

[3] Revenue from dedicated collections can be either exchange or nonexchange. Exchange revenue is included in the net cost of operations on the statement of changes in net position.

sources and net cost of operations attributed to funds from dedicated collections and all other funds separately on the U.S. government statement of operations and changes in net position. The U.S. government balance sheet displays separately the portions of net position attributable to funds from dedicated collections and all other funds.

A3. The Board reviewed SFFAS 27 to determine if the intended objectives were being achieved. Following an initial review by staff, a task force that included representatives from 23 federal agencies was formed. The task force assisted the Board by identifying concerns, testing alternatives, and reviewing proposals.

Outcome of Task Force Evaluation

A4. The following major issues were identified by FASAB staff and the Task Force:

a. **Term “Earmarked”** – Competing meanings of the term “earmarked” were causing confusion. This Statement changes the term “earmarked funds” to “funds from dedicated collections.” Conforming changes have been made throughout.

b. **Appropriateness of Classifications** – The appropriateness of certain types of funds being classified as funds from dedicated collections was questioned for the following reasons:

i. no non-federal (external) source of funding exists for some funds reported as funds from dedicated collections,

ii. classification of funds with mixed sources of funding where the predominant source is general fund appropriations may be misleading, and

iii. funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian and military) should not be reported as funds from dedicated collections because such funds account for employee-employer transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government*.

c. **Understandability** – Presenting funds from dedicated collections information on the face of component-level financial statements may not be the most understandable format for financial statement readers.

d. **Eliminations** – There was confusion over whether and how to perform and disclose eliminations.

A5. These issues are discussed in more detail in the sections that follow.

SUMMARY OF OUTREACH EFFORTS

A6. The exposure draft, *Revisions to Identifying and Reporting Earmarked Funds: Amending Statement of Federal Financial Accounting Standards 27*, was issued June 22, 2011, with comments requested by August 22, 2011. Upon release of the exposure draft, notices and press releases were provided to

a. The Federal Register;

b. *FASAB News;*

c. The *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* and the *CPA Letter,* and *Government Accounting and Auditing Update;*

d. The CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network; and

e. Committees of professional associations generally commenting on exposure drafts in the past.

A7. This broad announcement was followed by direct mailings of the exposure draft to the members of the Earmarked Funds Task Force. A list of the participating agencies is provided at Appendix D.

A8. To encourage responses, a notice was sent to the FASAB's ListServ and to the FASAB's Twitter followers. In addition, a reminder was provided on August 16, 2011, to our Listserv. We also contacted affected agencies directly if a response had not been received by the date requested.

RESULT

A9. We received 23 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		3
Auditors	2	1
Preparers and financial managers	17	

A10. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below and are discussed in detail in the sections that follow.

A11. Terminology: All respondents agreed that the term "earmarked funds" should be changed, and most respondents agreed with the term "funds from dedicated collections."

A12. Appropriateness of Classifications:

a. All respondents agreed with the requirement for an external source of funding.

b. A majority of respondents agreed with the Board's proposal addressing the predominant source of funding when evaluating individual funds.

c. All respondents agreed with the exclusion of certain funds.

A13. Understandability:

a. A majority of respondents agreed with the Board's minority proposal to permit note-only reporting.

b. A majority of respondents agreed with the option of an alternative format of parenthetical amounts within line item titles.

A14. Eliminations: A majority of respondents agreed that combined or consolidated amounts may be reported and must be labeled accordingly.

A15. Other:

a. A majority of respondents agreed with an explicit requirement for data to be in sufficient detail to support government-wide reporting.

b. A majority of respondents agreed with the proposed effective date of fiscal year 2012.

Terminology – "Earmarked Funds" changed to "Funds from Dedicated Collections"

A16. The Board believes that the term "earmarked funds" has become confusing to readers because of the increasing focus on a similar term, "earmarking," which refers to earmarked spending. Earmarking occurs when congressional direction (provided in legislation, report language or other communication) designates appropriations for a specific purpose. In contrast, the reporting requirements of SFFAS 27 are focused on collections that are distinct from the government's general revenues and are dedicated for a specific purpose.

A17. The Board believes that the new term, "funds from dedicated collections," is a unique and descriptive term that will not be confused with other commonly used terms. In addition, it explicitly states the reason for separate reporting (dedicated collections).

Appropriateness of Classifications

A18. A primary objective of SFFAS 27 was that:

> …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 funds from dedicated collections for the designated activities, purposes or benefits.[4]

A19. The need for greater transparency was explained as follows:

> …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.[5]

A20. By providing separate presentation of the cumulative results of operations attributable to funds from dedicated collections, the commitment to restrict the use of net position, or "net assets," accumulated in funds from dedicated collections would be apparent. In developing SFFAS 27, the Board noted that a 2001 report identified three hundred and ninety-two possible funds from dedicated collections. Annual revenues and other financing sources for those funds ranged from negligible amounts to over half a trillion dollars. Accumulated balances ranged from zero to over a trillion dollars.[6] However, upon implementation in 2006, five of the sixteen largest funds from dedicated collections reported a negative net position.

A21. Not previously having been aware of funds from dedicated collections with negative net positions, staff questioned whether these funds are appropriately included as funds from dedicated collections. Further research showed that some of the funds with negative net

[4] SFFAS 27, Basis for Conclusions, paragraph 63.

[5] SFFAS 27, Basis for Conclusions, paragraph 62.

[6] SFFAS 27, Basis for Conclusions, paragraph 3.

positions did not receive any funding from dedicated collections. For example, the Department of Defense Medicare Eligible Retiree Health Care Fund receives income from three sources: an annual Treasury payment made on behalf of the military services at the beginning of the year based on average budgeted force strengths, annual payments from the Treasury to amortize the unfunded liability, and investment income on Treasury securities.

A22. The intent of SFFAS 27 was that the specifically identified revenues and other financing sources required to meet the criteria in paragraph 11 of SFFAS 27 should be from a source that is non-federal – that is, a source that is external to the federal government. Evidence of that intent is found in the SFFAS 27 explanation that such funding 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[7]. However, SFFAS 27 did not explicitly state that a non-federal source of funds was required and current reporting practices vary. To ensure that funds reported as funds from dedicated collections are those where such a public expectation exists, this Statement provides amendments to SFFAS 27 to explicitly state that the source of the specifically identified revenues or other financing source must be external to the federal government, and to clarify the distinction between funds from dedicated collections and the general fund.

Funds with Mixed Sources of Funding

A23. In implementing SFFAS 27, agencies classified numerous funds primarily funded by general fund appropriations as funds from dedicated collections. The Board believes that guidance is needed for funds with mixed sources of funding (that is, a combination of (a) revenues and other financing sources that meet the criteria in paragraph 11 of SFFAS 27 ("non-federal") and (b) general fund appropriations ("federal")). In some such cases, the funding from non-federal sources is insignificant both to the component entity and the government as a whole. The Board believes that because a "fund" (usually associated with a Treasury account fund symbol) is the smallest financial accounting unit in the federal government, a fund with mixed sources of funding including dedicated collections presents special challenges in meeting the objectives of SFFAS 27. Conceptually, the portion representing dedicated collections should be separately identified. In the Board's view, separately accounting for the portion of these funds representing dedicated collections would impose reporting burdens in excess of any benefits. However, classifying both dedicated collections and general fund appropriations as "dedicated collections" would overstate restricted revenue in component entity reports.

[7] SFFAS 27, Basis for Conclusions, paragraph 54.

A24. To avoid such overstatements while minimizing reporting burdens, the Board believes that to be classified as a fund from dedicated collections, a fund should be predominantly funded by revenues from non-federal sources that meet the definition and criteria in paragraph 11 of SFFAS 27 ("non-federal revenues"). However, if the non-federal revenues supporting the fund are material to the reporting entity, the Board believes that the fund should be classified as a fund from dedicated collections even if the non-federal revenues are not the predominant source of inflows of the fund for which they are collected. The Board believes that this approach will result in a cost-effective solution. Material non-federal revenues that meet the definition and criteria in paragraph 11 of SFFAS 27 will be disclosed and costs will not be incurred to provide special accountability for immaterial amounts of non-federal revenue that meet the criteria but are commingled with other financing sources provided through general fund appropriations. The Board has accordingly provided an exception to the "predominant source of funds" principle in cases where the revenue that meets the criteria of paragraph 11 of SFFAS 27 is material to the reporting entity. In such cases, such as Medicare Parts B and D, the entire fund should be included.

Funds Excluded

A25. The Board believes that funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian and military) should not be reported as funds from dedicated collections because such funds account for employee-employer transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 56-96. SFFAS 5 addresses accountability for intra-governmental and employee contributions toward the cost of employee benefits and any resulting liabilities.

A26. In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that these funds reduce the cumulative amount to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes. Accordingly, this Statement provides that such funds should be excluded from the category of funds from dedicated collections.

Understandability

A27. Members of the task force expressed concerns regarding the understandability of the display of separate amounts on the face of the component entity financial statements for funds from dedicated collections and all other funds, as currently required by SFFAS 27. The task force believes that this adds complexity to an already challenging financial presentation. Further, it may prevent display of comparative financial statements on the same page. The task force believes that all information concerning funds from dedicated collections in the component entity financial statements should be disclosed in the notes.

A28. The Board believes that component entity financial statements need not display funds from dedicated collections and all other fund totals separately on each line item, provided that certain key data remains on the face of the statements. Component entity financial statements must be read with the understanding that they provide information about a single component of the federal government. Each component acts as an agent of that government and restrictions are placed on the use of most funds available to agencies whether the funds are from dedicated collections or not. While special accountability for the use of funds can be conveyed through component entity reports by presenting information on significant individual funds, the cumulative financial implications of total funds from dedicated collections are best understood from the government-wide perspective since the focus is on intra-governmental borrowing.

A29. However, the Board believes that users may be misled if a component entity has no information on the face of the basic financial statements about the magnitude of funds from dedicated collections that are reserved for use for designated activities, benefits, or purposes. Accordingly, the Board is requiring that component entities continue to report net position attributable to funds from dedicated collections on the balance sheet. In addition, the Board believes certain component entities should continue to report funds from dedicated collections separately on the face of the statement of changes in net position, and that component entities not required to report on the face of the statement should include a reference to the note on the face of the statement of changes in net position.

Eliminations

A30. SFFAS 27 provided confusing guidance on eliminations for component entities by implying that the funds from dedicated collections disclosure should include eliminations between funds from dedicated collections and all other funds. Practice has varied as a result. The amendments eliminate the confusing guidance and instead provide that combined or consolidated totals are permitted so long as they are properly labeled.

A31. The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> 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.[8]

[8] SFFAS 27, Basis for Conclusions, paragraph 63.

A32. Another objective of SFFAS 27 relates to special accountability:

> 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.[9]

A33. The above objectives of SFFAS 27 focus primarily on the accumulated net position of funds from dedicated collections. Because net position is not affected by eliminations, presentation of eliminations is not necessary to meet the objectives of SFFAS 27. In addition, because the focus of special accountability is necessarily on individual funds (or programs) – members question whether the consolidated total is useful for assessing the status of funds from dedicated collections available for the individual purposes established in law.

A34. Members believe that a broader study of fund reporting is needed. Specifically, a fund reporting project would address the question of whether consolidated or combined amounts are more useful when reporting on a specific class of funds. Until such a study is completed, the Board believes it is acceptable to report either consolidated or combined amounts and the amounts must be labeled accordingly.

Support for Government-wide Reporting

A35. To address concerns expressed by representatives of the Department of the Treasury, this Statement also proposes amendments to explicitly require that component entity reporting should fully support the required government-wide reporting on funds from dedicated collections in accordance with paragraphs 29 – 33 of SFFAS 27.

Board Approval

A36. This Statement was approved for issuance by all members of the Board. Written ballots are available for public inspection at the FASAB's offices.

[9] SFFAS 27, Basis for Conclusions, paragraph 54.

Appendix B: Text of SFFAS 27 Accounting Standards, as Amended

Definition of Funds from Dedicated Collections

11. Generally, funds from dedicated collections are financed by specifically identified revenues,[3a] provided to the government by non-federal sources, 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 federal government's general revenues. The three required criteria for a fund from dedicated collections are:

    1. A statute committing the federal government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source[3b] only for designated activities, benefits or purposes;

    2. Explicit authority for the fund to retain revenues and/or 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[4] on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the federal government's general revenues.

Footnote 3a: Such specifically identified revenues can be either exchange or nonexchange.

Footnote 3b: In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

Footnote 4: A "report" may be something other than stand-alone financial statements for the fund from dedicated collections.

Application of the Definition

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. A fund from dedicated collections 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 "funds from dedicated collections" 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 funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related 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] Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:

    1. its predominant sources of revenue and other financing sources are non-federal sources meeting the paragraph 11.1 criterion, or

    2. it has non-federal revenue and other financing sources meeting the paragraph 11.1 criterion[5a] that are material to the reporting entity.

    For example, as currently funded, Medicare Parts B and D do not have non-federal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.

Footnote 5: National Council on Governmental Accounting Statement 1, par. 16.

Footnote 5a: In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts of funding sources vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:

1. long-term expectations rather than periodic results that may fluctuate

2. 36-month averages

Changes in classification of funds from year to year should be disclosed.

Distinct from the General Fund

14. Whereas funds from dedicated collections are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not dedicated by law for a specific purpose and by 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 funds from dedicated collections reflects a longer (if not indefinite) government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Funds from dedicated collections may be given authority to make expenditures by means of 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 budget authority is provided by authorizing legislation or annual appropriations acts, the funds are reserved or restricted to the designated activity, benefit or purpose.

Distinct from Fiduciary Activities

15. The activity of funds from dedicated collections differs from fiduciary activities primarily in that in funds from dedicated collections, 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 uphold.[6] Therefore, even though a fund from dedicated collections 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.

Footnote 6: See SFFAS 31, 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.

Distinct from Private Sector Trust Funds

16. Although funds from dedicated collections 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 funds from dedicated collections in the federal government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship.

17. A fund from dedicated collections 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.)

Exclusions from Reporting Requirements

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. Funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian or military) should not be classified as funds from dedicated collections because such funds account for employer-employee transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 56-96.[6a] In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that the large negative net position of these funds obscures the large cumulative amount that needs to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes.

    Footnote 6a: Because classification and reporting should be made at the level of an individual fund, portions of funds, such as the Federal Employees Compensation Account portion of the Unemployment Trust Fund, should not be excluded because of this provision.

Reporting for Funds from Dedicated Collections

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

19. The portion of cumulative results of operations and unexpended appropriations attributable to funds from dedicated collections should be shown separately on the balance sheet. This standard does not require funds from dedicated collections to be separately shown on the statement of net cost. Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the statement of changes in net position if:

    1. dedicated collections are the predominant source of revenue and other financing sources for the **component entity**, or

    2. one or more of the entity’s funds from dedicated collections

a. is of immediate concern to constituents of the fund,

b. is politically sensitive or controversial,

c. is accumulating large balances, or

d. the information provided in the financial statements would be a primary source of financial information for the public.

For example, the Social Security and Medicare programs are of immediate concern to their constituents; both programs have a direct current or future impact on the majority of the general public.

19a. Entities may present combined or consolidated amounts and the presentation must be labeled accordingly.

19b. Component entities that do not separately show amounts from dedicated collections on the statement of changes in net position should refer on the face of the statement of changes in net position to the note on funds from dedicated collections.

20. Most revenues and other financing sources that are dedicated collections are reported 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 revenues and other financing sources that are dedicated collections, 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]

Footnote 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.

Disclosure

21. A component entity should disclose[8] all funds from dedicated collections for which it has program management responsibility by either a list (by official title) or a statement indicating where the list can be obtained (e.g., a website reference or contact information). A fund from dedicated collections 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.)

Footnote 8: Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

22. Information should be disclosed for each individual fund from dedicated collections. An exception is provided for component entities having numerous individual funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all the entity's funds from dedicated collections:

    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 providing gross cost, exchange revenue, net cost of operations, nonexchange revenues by major type and all other, other financing sources by major type and all other, and change in net position.

    Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. The information required by this paragraph for funds from dedicated collections may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. The information must be in sufficient detail to support reporting requirements for the U.S. government-wide financial statements in paragraphs 29 and 30. Information for funds not presented individually may be aggregated. The total net position shown in the note disclosure should agree with the total net position for funds from dedicated collections shown on the face of the component entity's balance sheet. [9]

    Footnote 9 was rescinded by SFFAS 43, *Revisions to Identifying and Reporting Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27.*

23. The following information should be disclosed for each individually reported fund from dedicated collections, 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 funds from dedicated collections to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

    a. quantitative factors such as

        1. the percentage of the reporting entity's revenues from dedicated collections or

        2. cumulative results of operations from such funds; and

    b. qualitative factors such as

        1. whether a fund from dedicated collections is of immediate concern to constituents of the fund,

        2. whether it is politically sensitive or controversial,

        3. whether it is accumulating large balances, or

        4. whether the information provided in the financial statements would be the primary source of financial information for the public.

25. The total net position of all funds from dedicated collections shown in the note disclosure should agree with the net position of funds from dedicated collections shown on the face of the component entity's balance sheet.

26. In accordance with the provisions of paragraph 20 or footnote 5a of paragraph 13, if a component entity reports a different portion of a program funded by dedicated collections than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change. This applies if a component entity does not report a fund from dedicated collections that it reported in the previous year. It also applies if a component entity reports a fund from dedicated collections that it did not report in the previous year.

Note on Investments

27. Investments in Treasury securities for funds from dedicated collections 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 funds from dedicated collections. Instead, the cash generated from such funds is used by the U.S. Treasury for general government purposes.

- Treasury securities are issued to the fund as evidence of dedicated collections 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 a fund from dedicated collections 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 fund from dedicated collections 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 Investments in Treasury securities for funds from dedicated collections should be accompanied by a note that explains the following issues: above.

Intra-governmental Investments in Treasury Securities

The federal government does not set aside assets to pay future benefits or other expenditures associated with funds from dedicated collections (or name/s of fund/s). The dedicated cash receipts collected from the public into the 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. Funds from dedicated collections should be shown separately on the U.S. government statement of operations and changes in net position. The portion of net position attributable to funds from dedicated collections 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.)

Footnote 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.

Disclosure

30. Specific information should be disclosed for selected funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all funds from dedicated collections.

    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.

    The disclosure may present combined or consolidated amounts and the presentation must be labeled accordingly

31. The information for funds from dedicated collections 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 funds from dedicated collections shown on the face of the balance sheet.

32. A note disclosure should provide a reference to component reports for additional information about individual funds from dedicated collections.

33. A note disclosure should provide a general description of funds from dedicated collections and an explanation of how the federal government as a whole could provide the resources represented by the balance in Treasury securities held by funds from dedicated collections.

34. A fund from dedicated collections 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. [Paragraph 37 was superseded by paragraph 34 of SFFAS 31, which rescinded paragraphs 83 through 87 of SFFAS 7.]

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 Funds from Dedicated Collections*. 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 ~~earmarked funds~~ dedicated collections, 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 C: Illustrative Component Entity Financial Statements

Component entities have the option to use separate lines or columns to display information on funds from dedicated collections on the face of the balance sheet and statement of changes in net position (Option A), or to use an alternative format, such as parenthetical amounts within line item titles (Option B).

The following examples are illustrative only and are intended to show how the information required in paragraph 19 might be displayed. These examples are not intended to be all inclusive and other acceptable alternatives may be developed by preparer.

Note: Although these illustrations show combined totals for dedicated collections and all other funds where those two categories of funds are reported separately, component entities may also opt to report consolidated amounts for dedicated collections and all other funds, respectively (i.e., after eliminations within each category of funds). Regardless of whether combined or consolidated amounts are reported for each category of funds, entity-wide totals for all funds should be consolidated amounts.

Option A: Illustrative Balance Sheet with Amounts in Separate Lines

	FY 2XX1	FY 2XX0
Entity assets:		
Fund balance with Treasury	$xxx	$xxx
Cash (and other monetary assets)	xxx	xxx
Investments:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Inventories and related properties	xxx	xxx
Physical assets	xxx	xxx
Total entity assets	**xxx**	**xxx**
Non-entity assets:		
Fund balance with Treasury	xxx	xxx
Cash	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Total non-entity assets	xxx	xxx
Total assets	**$xxx**	**$xxx**

	FY 2XX1	FY 2XX0
LIABILITIES:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	$xxx	$xxx
Governmental liabilities:		
Payables	xxx	xxx
Total liabilities covered by budgetary resources	**xxx**	**xxx**
Liabilities not covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	xxx	xxx
Governmental liabilities:		
Payables	xxx	xxx
Amounts held for others	xxx	xxx
Total liabilities not covered by budgetary resources	**xxx**	**xxx**
Total liabilities	**xxx**	**xxx**

NET POSITION		
Unexpended appropriations - Funds from Dedicated Collections (Combined Totals)– See Note X	xx	xx
Unexpended appropriations – All Other Funds (Combined Totals)	xx	xx
Cumulative results of operations - Funds from Dedicated Collections (Combined Totals) – See Note X	xx	xx
Cumulative results of operations – All Other Funds (Combined Totals)	xx	xx
Total Net Position – Funds from Dedicated Collections (Combined Totals) – See Note X	xx	xx
Total Net Position – All Other Funds (Combined Totals)	xx	xx
Total Net Position	xxx	xxx
Total liabilities and net position	**$xxx**	**$xxx**

Option B: Illustrative Balance Sheet with Parenthetical Amounts

	FY 2XX1	FY 2XX0
Entity assets:		
Fund balance with Treasury	$xxx	$xxx
Cash (and other monetary assets)	xxx	xxx
Investments:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Inventories and related properties	xxx	xxx
Physical assets	xxx	xxx
Total entity assets	**xxx**	**xxx**
Non-entity assets:		
Fund balance with Treasury	xxx	xxx
Cash	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Total non-entity assets	xxx	xxx
Total assets	**$xxx**	**$xxx**
LIABILITIES:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	$xxx	$xxx
Governmental liabilities:		
Payables	xxx	xxx
Total liabilities covered by budgetary resources	**xxx**	**xxx**

	FY 2XX1	FY 2XX0
Liabilities not covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	xxx	xxx
Governmental liabilities:		
Payables	xxx	xxx
Amounts held for others	xxx	xxx
Total liabilities not covered by budgetary resources	**xxx**	**xxx**
Total liabilities	**xxx**	**xxx**
NET POSITION		
Unexpended appropriations (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) – See Note X)	xxx	xxx
Cumulative results of operations (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) - See Note X)	xxx	xxx
Total net position (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) - See Note X)	xxx	xxx
Total liabilities and net position	**$xxx**	**$xxx**

Option A: Illustrative Statement of Changes in Net Position with Amounts in Separate Columns

Note: Certain component entities are not required to report on the face of the Statement of Changes in Net Position. Entities may present combined or consolidated amounts and the presentation must be labeled accordingly.

FY 2XX1	Funds from Dedicated Collections (Combined Totals) (See Note X)	All Other Funds (Combined Totals)	Eliminations	Consolidated Totals
Cumulative Results of Operations:				
Beginning balance, as adjusted	xxx	xxx	x	xxx
Budgetary Financing Sources:				
Other adjustments	xxx	xxx	x	xxx
Appropriations used	xxx	xxx		xxx
Non-exchange revenue	xxx	xxx	x	xxx
Donations and forfeitures of cash and cash equivalents	xxx	xxx		xxx
Transfers in/out without reimbursement	xxx	xxx	x	xxx
Other	xxx	xxx	x	xxx
Other Financing Sources				
Donations and forfeitures of property	xxx	xxx		xxx
Transfers in/out without reimbursement	xxx	xxx	x	xxx
Imputed financing	xxx	xxx	x	xxx
Other	xxx	xxx	x	xxx
Total Financing Sources	xxx	xxx	x	xxx
Net Cost of Operations	xxx	xxx	x	xxx
Net Change	xxx	xxx	x	xxx
Cumulative Results of Operations	xxx	xxx	x	xxx
Unexpended Appropriations:				
Beginning Balance	xxx	xxx	x	xxx
Budgetary Financing Sources:				
Appropriations received	xxx	xxx	x	xxx
Appropriations transferred in/out	xxx	xxx	x	xxx
Other adjustments	xxx	xxx	x	xxx
Appropriations used	xxx	xxx		xxx
Total Budgetary Financing Sources	xxx	xxx	x	xxx
Total Unexpended Appropriations	xxx	xxx	x	xxx
Net Position	xxx	xxx	x	xxx

Option B: Illustrative Statement of Changes in Net Position with Parenthetical Amounts

Note: Certain component entities are not required to report on the face of the Statement of Changes in Net Position.

	FY 2XX1	FY 2XX0
Cumulative Results Of Operations:		
Beginning balance, as adjusted (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Budgetary Financing Sources:		
Other adjustments	xxx	xxx
Appropriations used	xxx	xxx
Non-exchange revenue	xxx	xxx
Donations and forfeitures of cash and cash equivalents	xxx	xxx
Transfers in/out without reimbursement	xxx	xxx
Other	xxx	xxx
Other Financing Sources		
Donations and forfeitures of property	xxx	xxx
Transfers in/out without reimbursement	xxx	xxx
Imputed financing	xxx	xxx
Other	xxx	xxx
Total Financing Sources (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Net Cost of Operations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) – See Note X)	xxx	xxx
Net Change	xxx	xxx
Cumulative Results of Operations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Unexpended Appropriations:		
Beginning Balance (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) – See Note X)	xxx	xxx
Budgetary Financing Sources:		
Appropriations received	xxx	xxx
Appropriations transferred in/out	xxx	xxx
Other adjustments	xxx	xxx
Appropriations used	xxx	xxx
Total Budgetary Financing Sources (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Total Unexpended Appropriations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Net Position	xxx	xxx

Appendix D: Earmarked Funds Task Force Participating Agencies

U.S. Department of Agriculture
Department of Commerce
Commodity Futures Trading Commission
Department of Defense
Department of Energy
Environmental Protection Agency
Federal Communications Commission
Government Accountability Office
Department of Health and Human Services
Department of Homeland Security
Department of Housing and Urban Development
Department of the Interior
Department of Justice
Department of Labor
Office of Management and Budget
Office of Personnel Management
Railroad Retirement Board
Securities and Exchange Commission
Social Security Administration
State Department
Department of Transportation
Treasury Department (main Treasury and CFR reporting)
Department of Veterans Affairs

Appendix E: Abbreviations

FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Statement of Federal Financial Accounting Standards 44: Accounting For Impairment Of General Property, Plant, And Equipment Remaining In Use

Status

Issued	January 3, 2013
Effective Date	For fiscal periods beginning after September 30, 2014 with early implementation encouraged
Affects	None.
Affected by	None.

Summary

This Statement establishes accounting and financial reporting standards for impairment of general property, plant, and equipment (G-PP&E) remaining in use, except for internal use software. G-PP&E is considered impaired when there is a significant and permanent decline in the service utility of G-PP&E or expected service utility for construction work in progress. A decline is permanent when management has no reasonable expectation that the lost service utility will be replaced or restored.[1]

This Statement does not anticipate that entities will have to establish additional or separate procedures beyond those that may already exist, such as those related to deferred maintenance and repairs, to search for impairments. Impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonably assure identification and communication of potential material impairments, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. Management may determine that existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments and implement appropriate additional processes and internal controls.

Entity management should consider documenting the decisions it makes while determining how to implement the requirements of this Statement. Such decisions should include consideration of materiality. Materiality considerations should include an assessment of the impact to the cost of service(s) before and after the impairment.

[1] This Statement should not be directed to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

Recognition of impairment losses is dependent upon a two-step process that entails (a) identifying potential impairments and (b) testing for impairment. The losses should be reasonably estimated by determining the portion of the decline in the net book value of the G-PP&E attributable to the lost service utility.

This Statement improves financial reporting by requiring entities to report the effects of G-PP&E impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the G-PP&E or upon disposal of the G-PP&E. This will enable users of financial statements to discern the cost of impairments when they occur, the financial impact on the reporting entity, and the cost of services provided following the impairment. This Statement also enhances comparability of financial statements between entities by requiring all entities to account for impairments in a similar manner.

Table of Contents

Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment,* contains principles-based guidance concerning **general property, plant, and equipment (G-PP&E)**[2] that is removed from service due to **total (full) impairment** of G-PP&E or other reasons. SFFAS 6 requires that G-PP&E be removed from G-PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement, or removal from service it no longer provides service in the operations of the entity.[3] SFFAS 6 does not address situations where there is less than total (full) impairment of G-PP&E.

2. SFFAS 10, *Accounting for Internal Use Software,* provides guidance for the impairment of **internal use software**.[4] This Statement does not alter existing requirements regarding internal use software.

3. This Statement provides accounting and reporting requirements for **partial impairments** of G-PP&E remaining in use and construction work-in-process.

Materiality

4. 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

[2] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[3] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment,* which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

[4] SFFAS 10, at paragraphs 28 through 31, provides additional procedures for recognizing and measuring impairment related to internal use software. The provisions in SFFAS 10 and SFFAS 6 are the same regarding situations where the software or G-PP&E is impaired and will be removed from service in its entirety. Both standards provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, SFFAS 10 also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

5. The standards are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

Standards

Scope and Applicability

6. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

7. This Statement applies to G-PP&E[5] except internal use software. This Statement establishes guidance on accounting for the impairment of G-PP&E remaining in use, including construction work in process. The provisions of this Statement are to be applied when indicators of potential impairment, as specified in this Statement, are identified by the entity. The entity is not required to conduct an annual or other periodic survey solely for the purpose of applying these standards. Existing processes that may identify indicators for potential impairment include routine assessments regarding the continued operational and functional capacity of G-PP&E, entity mission requirements, impacts of significant events or changes in circumstances, and deferred maintenance and repairs. The results of such processes may serve as the basis for applying these standards.

[5] G-PP&E is any property, plant, and equipment (PP&E) used in providing goods or services and includes, among other types of PP&E, multi-use heritage assets, capitalized improvements to stewardship land, and construction work-in-process. PP&E includes land and land rights that are acquired for or in connection with items of G-PP&E used to provide government services or goods. G-PP&E does not include heritage assets, such as historic and national landmarks, and stewardship land; reporting for these assets should be in accordance with SFFAS 29, *Heritage Assets and Stewardship Land*. The cost of G-PP&E is capitalized, i.e., recorded as assets on the balance sheet. For detailed characteristics of and accounting for G-PP&E, see SFFAS 6, par. 23 through 45.

Definition of Impairment

8. Impairment is a significant[6] and permanent decline in the service utility of G-PP&E, or expected service utility for construction work in process. Entities generally hold G-PP&E because of the services they provide or will provide in the future; consequently, impairments affect the service utility of the G-PP&E. The events or changes in circumstances that lead to impairments are not considered normal and ordinary.[7] That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating its useful life.

9. The service utility of G-PP&E is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the level of utilization, which is the portion of the usable capacity currently being used. The current usable capacity of G-PP&E may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws, or regulations or other changes in environmental or economic factors, or change in the manner or duration of use. Usable capacity may be different from maximum capacity[8] in circumstances in which surplus capacity (the excess capacity over the usable capacity) is needed for safety, economic, operational readiness or other reasons. G-PP&E that experience decreases in utilization, and the simultaneous existence of or increases in surplus capacity not associated with a decline in service utility are not considered impaired.

Identification of Potential Impairment Loss – A Two-step Process

10. Generally, G-PP&E remaining in use is impaired if the decline in the service utility of the G-PP&E is significant and deemed permanent.

[6] The determination of whether or not an item is significant is a matter of professional judgment. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations. Determining if a decline in service utility is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

[7] Normal and ordinary are defined as events or circumstances that fall within the expected useful life of the PP&E such as standard maintenance and repair requirements.

[8] Maximum capacity is the usable capacity plus any surplus capacity.

11. The determination of whether G-PP&E remaining in use is impaired, as defined in paragraph 8 above, includes (a) identifying potential impairment indicators and (b) testing for impairment. G-PP&E would be identified as potentially impaired as a result of the occurrence of significant events or changes in circumstances, or routine asset management processes.

Step 1 – Identify Indicators of Potential Impairment

12. Some common indicators of potential impairment include those listed below. The indicators identified are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment is necessary given the circumstances.

    a. evidence of physical damage

    b. enactment or approval of laws or regulations which limit or restrict G-PP&E usage

    c. changes in environmental or economic factors

    d. technological changes or evidence of obsolescence[9]

    e. changes in the manner or duration of use of G-PP&E

    f. construction stoppage or contract termination

    g. G-PP&E idled or unserviceable for excessively long periods[10]

G-PP&E Identified From Significant Events or Changes in Circumstances

13. Events or changes in circumstances affecting G-PP&E that may indicate impairment are sometimes significant. Significant events or changes in circumstances are conspicuous or

[9] Technological changes or evidence of obsolescence should be considered along with other factors when assessing impairment. For example, if obsolete G-PP&E continues to be used, the service utility expected at acquisition may not be diminished. Further, when obsolescence is expected, the declining service utility of G-PP&E subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as its utility diminishes when compared to that of later versions of the same asset.

[10] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

known to the entity's management or oversight entities. This Statement does not require entities to conduct an annual or periodic survey solely to identify potential impairments of G-PP&E. Rather, significant events or changes in circumstances affecting G-PP&E that may indicate impairment are conspicuous or known to the entity's management or oversight entities and are generally expected to have prompted consideration[11] by management, oversight entities, or others (e. g., the media).

G-PP&E Identified from Asset Management Reviews (e.g., portfolio surveys)

14. Existing asset management processes may include portfolio surveys that consider matters such as the continued operational and functional capacity of G-PP&E, entity mission requirements, or deferred maintenance and repairs assessments. Potentially impaired G-PP&E may be identified from such surveys and further evaluated through the two-step process.

Reduced Demand Should Not Be Considered a Discrete or Sole indicator of Impairment

15. As explained in paragraph 9 above, reduced demand for the services of G-PP&E should not be considered a discrete or sole indicator of impairment. Instead, there should also be evidence of an underlying potential impairment resulting in the reduced demand. In these circumstances, the causes behind such changes in demand should be evaluated in light of the indicators listed in paragraph 12 and the G-PP&E should be tested for impairment.

Step 2 - Impairment Test

16. G-PP&E identified through the processes described in paragraphs 10 through 15 should be tested for impairment by determining whether the following two factors are present:

    a. **The magnitude of the decline in service utility (as defined in par. 9) is significant**. The costs are now disproportionate to the new expected service utility. Such costs should include operational and maintenance costs. Judgment is required to determine whether the decline is significant. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations.

    b. **The decline in service utility is expected to be permanent.** The decline is considered permanent when management has no reasonable expectation that the lost

[11] Consideration might include but is not limited to management discussions, internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

service utility will be replaced or restored. That is, management expects that the G-PP&E will remain in service so that its remaining service utility will be utilized. In contrast, reasonable expectation that the lost service utility will be replaced or restored may exist when management has: (1) specific plans to replace or restore the lost service utility of this G-PP&E, (2) committed or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E.

17. For construction work in process, the testing of impairment discussed in paragraph 16 above should be performed over the period of expected future service utility rather than current service utility.

Determining the Appropriate Measurement Approach

18. Impairment losses on G-PP&E that will continue to be used by the entity[12] should be estimated using a measurement method that reasonably[13] reflects the diminished service utility of the G-PP&E. The goal of the measurement methods discussed below is to reasonably estimate the portion of the net book value associated with the diminished service utility of the G-PP&E. A specific method, including one of the methods listed below, would not be considered appropriate if it would result in an unreasonable net book value associated with the remaining service utility of the G-PP&E. Within an entity, one method may not be appropriate for measuring all impairments. Also, a reasonable method may nonetheless result in no impairment loss to be recognized. Regardless of the method used, recognition of the loss should be limited to the asset's net book value at the time of impairment. Widely recognized methods for measuring impairment include:

    a. **Replacement approach.** Impairment of G-PP&E with physical damage generally may be measured using a replacement approach. This approach uses the estimated cost to replace the lost service utility of the G-PP&E at today's standards[14] to identify the portion of the historical cost of the G-PP&E that should be written off. For federal real property purposes, this cost can be derived from the plant replacement value (PRV).

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[12] See SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 38 and 39 for guidance regarding G-PP&E that will not continue to be used by the entity.

[13] Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.

[14] For example, *"at today's standards"* would generally mean the use of current market prices for materials, labor, manufactured items and equipment using current building, manufacturing, or fabrication techniques in compliance with current statutory, regulatory, or industry standards.

This estimate can be converted to historical cost by restating (i.e., deflating) the estimated cost to replace the diminished service utility using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of the estimated cost to replace the diminished service utility over total estimated cost to replace the G-PP&E, to the net book value of the G-PP&E.

b. **Restoration approach.** Impairment of improvements made to stewardship land and multi-use heritage assets with physical damage may generally be measured by using a restoration approach. This approach uses the estimated cost to restore the diminished service utility of the G-PP&E to identify the portion of the historical cost of the G-PP&E that should be written off. This approach does not include any amounts attributable to improvements and additions to meet today's standards. The estimated restoration cost can be converted to historical cost by restating (i.e., deflating) the estimated restoration cost using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of estimated restoration cost to restore the diminished service utility over total estimated restoration cost to the net book value of the G-PP&E.

c. **Service units approach**. Impairment of G-PP&E that are affected by enactment or approval of laws or regulations or other changes in environmental/economic factors or are subject to technological changes or obsolescence generally may be measured using a service units approach. This approach compares the service units provided by the G-PP&E before and after the impairment event or change in circumstance to isolate the historical cost of the service utility of the G-PP&E that cannot be used due to the impairment event or change in circumstance. The amount of impairment is determined by evaluating the service provided by the G-PP&E - either maximum estimated service units or total estimated service units throughout the life of the G-PP&E - before and after the event or change in circumstance.

d. **Deflated depreciated current cost approach.** Impairment of G-PP&E that are subject to a change in manner or duration of use generally may be measured using a deflated depreciated current cost approach. This approach quantifies the cost of the service currently being provided by the G-PP&E and converts that cost to historical cost. A current cost for a G-PP&E to replace the current level of service is estimated. This estimated current cost is then depreciated to reflect the fact that the G-PP&E is not new, and then is subsequently deflated to convert it to historical cost dollars. A potential impairment loss results if the net book value of the G-PP&E exceeds the estimated historical cost of the current service utility (i.e., deflated depreciated current cost).

e. **Cash flow approach**. Impairment of cash or revenue generating G-PP&E, such as those used for business or proprietary-type activities, may be assessed using a cash flow approach. Under this approach, an impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value[15] or value-in-use estimate.[16] The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-PP&E. That assessment should be based on the net book value of the G-PP&E at the date it is tested for recoverability, whether in use or under development. If the net book value is not recoverable, the impairment loss is the amount by which the net book value of the G-PP&E exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E's net realizable value or value-in-use estimate.

f. **Lower of (1) Net Book Value or (2) Higher of Net Realizable Value or Value-in-Use Approach**. G-PP&E impaired from either construction stoppages or contract terminations, which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate. Impaired G-PP&E, which are not expected to provide service, should be accounted for and reported in accordance with SFFAS 6.

Recognizing and Reporting Impairment Losses

19. The loss from impairment should be recognized and reported in the statement of net cost when management concludes that the impairment is (1) a significant decline in service utility and (2) expected to be permanent. Such loss may be included in program cost(s) or cost(s) not assigned to programs consistent with SFFAS 4, *Managerial Cost Accounting Standards and Concepts*. However, in cases where an entity decides that an impairment loss should not be recognized, it could consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates, as appropriate.

[15] Net realizable value is 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.

[16] Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

20. The impairment loss should be recognized and reported regardless of whether the G-PP&E remaining in use is being depreciated individually or as part of a composite group. The impairment loss may be reported as a separate line item or line items on the statement of net cost. Deciding to display a separate line item or items on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from the impairment and the size of the impairment loss relative to the G-PP&E; and qualitative factors including whether the loss would be of interest to decision makers and other users.

21. A general description of the G-PP&E remaining in use for which an impairment loss is recognized, the nature (e.g., damage or obsolescence) and amount of the impairment, and the financial statement classification of the impairment loss should be disclosed in the notes to the financial statements. Such disclosures should be made in the period the impairment loss is recognized.

Diminished Service Utility Without Recognized Impairment Loss

22. Events, changes in circumstances, or asset management reviews might indicate that the future service utility of G-PP&E remaining in use has been adversely affected. However, if future service utility has been adversely affected but the impairment test determines that a loss need not be recognized, a change to the estimates used in depreciation calculations such as estimated useful life and salvage value should be considered.

G-PP&E That No Longer Provides Service

23. G-PP&E that no longer provides service or in the case of construction work in process where there is no expectation of future service by the entity, should be accounted for in accordance with SFFAS 6, paragraphs 38 and 39, and Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property Plant, & Equipment.*

Remediating Previously Reported Impairments

24. Subject to the entity's capitalization policies, if an entity later remediates the previously impaired G-PP&E remaining in use, the costs incurred to replace or restore the lost service utility should be accounted for in accordance with applicable standards. For example, costs

to prepare the site and install replacement facilities would be recognized in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*.

Recoveries

25. The impairment loss should be reported net of any associated recovery when the recovery and loss occur in the same year. Recoveries reported in subsequent years should be reported as revenue or other financing source as appropriate. If not otherwise apparent in the financial statements, the amount and financial statement classification of recoveries should be disclosed in the notes. The accounting for recoveries should be in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

Consolidated Financial Report of the U.S. Government

26. The U.S. government-wide financial statements should disclose the following if an impairment loss for G-PP&E remaining in use is recognized:

    a. a general description of what constitutes G-PP&E impairment,

    b. the consolidated G-PP&E impairment losses recognized by component entities, and

    c. a reference(s) to component entity report(s) for additional information.

Effective Date

27. The requirements of this Statement are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. In Statement of Federal Financial Accounting Standards (SFFAS) 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* issued in May 2003, the Board identified impairment as one of three areas (the other two being depreciation and deferred maintenance) that it desired to consider integrating into a comprehensive project. Complete impairment was addressed in SFFAS 6, *Accounting for Property, Plant, and Equipment,* through the requirements that general PP&E "…*be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess."* However, SFFAS 6 does not address partial impairment, even though the effects of partial impairment may be material in some cases. The Board decided to address asset impairment at the time it addressed deferred maintenance. Subsequent to the issuance of Statement of Federal Financial Accounting Standards 40: *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment* in May 2011, the Board initiated work on addressing potential enhancements to existing FASAB guidance regarding impairment.

A2. In evaluating an approach applicable to federal G-PP&E, the Board considered the approaches used in the following documents:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Superseded by FASB Accounting Standards Codification (ASC) 360)

- Governmental Accounting Standards Board (GASB) Statement (GASBS) 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*[17]

- International Public Sector Accounting Standard (IPSAS) 21, *Impairment of Non-Cash Generating Assets*

- IPSAS 26, *Impairment of Cash-Generating Assets*

A working group was organized to assist the Board in analyzing the impairment standards promulgated by the FASB, GASB, and the International Public Sector Accounting Standards Board (IPSASB). The working group's analysis was initially screened by the Deferred Maintenance and Asset Impairment (DM-AI) Task Force and subsequently tested with a broader community beyond the task force to obtain other points of view. The consensus recommendation was to use the GASBS 42 approach as a baseline for the development of a federal asset impairment standard.

Significant and Permanent Decline in Service Utility

A3. This Statement requires recognizing a potential impairment loss only when there is a significant and permanent decline in the G-PP&E's service utility. In reaching this decision, the Board considered and weighed (a) the need for relevant, reliable, and consistent financial reporting and (b) entity burden.

a. For financial reporting to be:

(i) relevant - a logical relationship must exist between the information provided and the purpose for which it is needed. G-PP&E impairment information is relevant because it is capable of making a difference in a user's assessment of how well the entity is meeting its federal asset stewardship responsibilities.

(ii) reliable - information needs to be comprehensive and nothing material should be omitted nor should anything be included that would likely cause the information to be misleading. The reporting of G-PP&E impairments significantly adds to the informational value and reliability of amounts presented in the entity's balance sheet and statement of net cost.

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(iii) consistent over time - an accounting principle or reporting method should be used for all similar transactions and events unless there is good cause to change. Establishing G-PP&E impairment standards significantly adds to consistent financial reporting.

b. The Board is aware of the increased demands that entities confront due to initiatives that attempt to better align and integrate entity mission, budget, and performance objectives. As such, the Board desires to issue a G-PP&E impairment standard that entities can effectively adopt without undue administrative burden while still satisfying the objectives of federal financial reporting.

Recognizing Impairments

A4. As discussed in paragraphs 13 and 14, impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonable assure such identification and communication, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. In the event management determines existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments, additional processes and internal controls may be necessary.

A5. The Board notes that not all significant events and/or changes in circumstances discussed by oversight bodies, management, or the media would necessarily be considered material to an entity's financial statements. Consequently, an entity must exercise judgment in this regard considering whether omitting or misstating information about the significant event and/or changes in circumstances makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or the misstatement. However, in cases where an entity decides that a significant event or change in circumstance is immaterial, it should consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates.

The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews that include the following types of G-PP&E assessments:

a. Condition assessments revealing evidence of physical damage, deterioration, and/or distresses such as for a building (1) damaged by fire or flood, (2) not adequately maintained or repaired, (3) associated with significant amounts of deferred maintenance and repairs and/or (4) exhibiting signs of advanced degradation that might adversely impact expected duration of use, each requiring remedial or replacement/restoration efforts to restore service utility

b. Functionality assessments revealing evidence of reduced capacity, inadequate configuration, change in entity mission, change in the manner or expected use, and enactment or approval of laws, regulations, codes or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet)

c. Obsolescence assessments revealing evidence of technological development or obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely or never used because newly acquired equipment provides better service

Common Indicators of Potential Impairment

A6. The Board considered the general approaches used by other standards-setters regarding the issues of impairment identification and testing. The DM-AI Task Force identified the GASB approach as being the most germane for federal application and recommended adopting its use with appropriate modifications. As a result, this Statement consists of a two-step process of (a) identifying potentially impaired G-PP&E through indictors of impairment and (b) testing to determine whether a potential impairment exists by comparing the net book value of the G-PP&E to a valuation reflecting the current state of the G-PP&E.

A7. Recognizing the administrative burden and costs involved in applying a test of potential impairment, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

A8. In order to limit the universe of G-PP&E tested for potential impairment because of cost-benefit considerations, the Board proposes two modifiers to the indicators: (a) the magnitude of the decline in service utility is significant and (b) the decline in service utility is permanent. The first modifier would limit testing for potential impairment to only G-PP&E that have experienced a significant decline in service utility. The second modifier would limit testing to only those G-PP&E where the decline in service utility is expected to be permanent. The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored and that the G-PP&E's remaining service utility can continue providing value.

A9. G-PP&E is to be considered impaired only when both of these two modifiers are present. When either of these conditions is not present, the decline in the service utility of the G-PP&E may be recognized through other methods such as changing useful life or salvage value estimates.

Determining if Magnitude of Decline in Service Utility is Significant

A10. Because measurement of a potential impairment is not required unless a significant decline in service utility occurs, management should assess the magnitude of the service decline. In cases where there is physical damage to G-PP&E, the significance can often be objectively assessed because the costs of remediation (i.e., replacement or restoration) may be relatively easy to determine, at least within a range of estimates. In circumstances other than those involving physical damage, significance may be discerned by less objective assessments such as:

(1) Whether management acts to address the situation. Management decisions may be indicative of a potential decline in service utility. For example, a specific action taken by management after a service decline may confirm that expenses exceed future benefit. Likewise, a decision by management to not address a service decline may be an indication the decline is not significant and a test of impairment is not required.

(2) The costs are disproportionate with the new expected service utility. For example, when comparing the benefits and related costs associated with the new expected service utility after the potential impairment with those benefits and related costs existing prior to the impairment, management may confirm that costs significantly exceed future benefit. As a result, the decline is significant and a test of impairment is required.

Selecting a Measurement Approach

A11. Professional judgment should be used when selecting a method to measure the decline in service utility of G-PP&E. Generally, potential impairments:

a. reflecting degradation or physical damage may be measured using a replacement approach or, for multi-use heritage assets, a restoration approach.

b. reflecting a change resulting from enactment or approval of laws or regulations or other changes in environmental/economic factors or from technological development or obsolescence generally may be measured using a service units approach.

c. reflecting a change in manner or duration of use or change in mission generally may be measured using deflated depreciated current cost approach.

d. for cash or revenue-generating G-PP&E may be measured using the cash flow approach.

e. arising from construction stoppages or contract terminations for assets which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate.

A12. The Board emphasizes that in estimating the diminished service utility of the G-PP&E, the measurement approach chosen should yield a reasonable estimate reflecting the diminished service capacity of the G-PP&E. Before using a specific method a determination should be made that it will result in (1) a reasonable estimate of diminished service capacity for the specific asset and (2) a reasonable net book value associated with the remaining service utility of the G-PP&E. There should not be a presumption of reasonableness attached to the use of any of these methods if the resultant calculations reflect an unreasonable estimate of the remaining service utility of the G-PP&E. For example, if using the replacement approach, a cost estimate to remediate the damage to an asset is equal to or greater than the asset's total replacement cost, the resultant calculation would lead to a full write-down of the carrying value. However, if the asset is to remain in use, the full write-down would be inappropriate because some service potential remains. In such a case, management should look to another method such as the deflated depreciated current cost approach to estimate the historical cost of the asset's residual service capacity that will continue to be used. Additionally, within an entity, one method may not be appropriate for measuring asset impairments across all categories or classes of assets. The Board notes that a reasonable methodology may not result in the recognition of an impairment loss.

Among Comparable Methods – Choose the Most Efficient

A13. The Board recognizes that there may be cases where more than one comparable method could be used to measure the decline in an asset's service utility. In such cases, the entity should use whichever method most reasonably reflects the diminished service utility. In cases where the methods under consideration are expected to yield similar results, management should adopt the most efficient method available given the circumstances.

Reduced Demand

A14. The Board notes that reduced demand for the services of G-PP&E should not be considered as a discrete or sole indicator of potential impairment. That is, reduced demand absent evidence of an underlying potential impairment resulting in that reduced demand is not an indicator of impairment. For example, decreased demand for the processing services of a mainframe computer because former users of the mainframe have transitioned to PC and server-based systems should be considered a change in demand not requiring impairment testing. However, if associated with an indicator of potential impairment such as evidence of obsolescence, then the mainframe should be tested for potential impairment.

A15. In addition, a decrease in demand <u>solely</u> resulting from the conclusion of a special project requiring large amounts of processing time on a mainframe computer that runs other applications should not be considered for impairment testing.

A16. A decrease in occupancy is another example of a change in demand. If a decrease in the occupancy of hospital beds prompts management to close a hospital, a change in manner or duration of use has also resulted and a test for impairment should be performed. However, a test for impairment is not required if the decrease in hospital beds results <u>solely</u> because the hospital is changing from an overcrowded condition to one in which occupancy rates are now below the maximum allowed. However, care should be taken to ensure that there is not a potential indicator of impairment that could require testing.

Estimating Potential Impairment Losses

A17. Measuring the cost of the lost service utility generally requires the use of estimates or approximations. According to Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, to be recognized an item must be measurable, meaning that a monetary amount can be determined with <u>reasonable</u> certainty or is <u>reasonably estimable</u> (underscoring added for emphasis). For this reason, the Board notes that it (1) does not seek exact precision in determining the lost service utility of the asset and (2) does not intend to direct or prescribe the use of any particular approach listed in paragraph 18.

A18. However, the Board notes that care should be taken when estimating potential impairment losses. For example, if a multi-use heritage asset requires testing for potential impairment, the restoration approach and not the replacement approach would generally provide for more accurate estimates. Although these approaches may appear to be identical, they are not. The replacement approach estimates the cost to replace the lost service utility of the G-PP&E <u>at today's standards</u> whereas the restoration approach does not. In either case, the required estimates used for the calculation inputs are different and can significantly affect the potential impairment loss measurement. Differences will arise because the replacement approach uses estimates reflecting today's current labor and material options and costs, modern standards, and installation methods whereas the restoration approach uses estimates that generally require using historically accurate (e.g., aesthetic or historic) materials and construction methods approved by an historic architect or historic preservationist to preserve the historic nature and value of the multi-use heritage asset.

A19. Entities should also ensure that impairment loss calculations exclude improvements or betterments. For example, assume that a portion of an old warehouse currently not being used suffers roof damage due to heavy snowfall. The entity decides not to repair the roof and to contain the damage by securing the adjoining area ensuring that there are no safety hazards. In this case, estimates for the construction of a new warehouse, including its roof should not include amounts for new types of roof ventilation systems, solar panel features, or green energy improvements, etc. Including such improvements or betterments might significantly affect the potential impairment loss measurement.

G-PP&E Impairment Loss Reversals and Remediation

A20. Impairments may be subsequently remediated or otherwise restored or may be reduced in future periods. The Board concluded that reversals of G-PP&E impairment losses should not be recognized. In reaching the decision not to allow for reversals of G-PP&E impairment losses, the Board concluded that because reversal events are expected to be rare occurrences, there is no compelling need for complexity or increased burden as benefits do not appear to justify costs.

A21. The Board concluded remediation of a previously reported impairment loss, is a change that results in an addition to the cost basis. Specifically, should management later decide to replace or restore an asset's lost service utility the costs incurred to do so become part of the G-PP&E's new cost basis. It is the Board's opinion that such a practice is consistent with the operating performance objective of federal financial reporting; users will be able to evaluate the service efforts, costs, and accomplishments of the reporting entity based on the revised cost basis.

Recoveries

A22. Recoveries may be accounted for as either exchange or non-exchange transactions, depending on the nature of the related revenue that would be recorded. In accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting:*

a. Exchange revenues should be recognized when goods or services are provided to the public or another government entity at a price. An example would be commercial insurance purchased in connection with G-PP&E belonging to a public-private arrangement.

b. Non-exchange revenues should be recognized 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. An example would be a donor's pledged contribution associated with a capital project restoration effort. In cases where the collecting and reporting entities are different, it is important to note that non-exchange revenue amounts should be measured by the collecting entities and recognized for financial statement reporting by the entities legally entitled to the revenue.

Distinguishing between Depreciation and Impairment

A23. Depreciation systematically and rationally allocates the historical cost of the G-PP&E's service utility to the benefitting periods. The asset's costs are allocated (i.e., the asset is depreciated) across multiple periods based on asset management plans and formulas, including such variables as expected useful life of the asset, usage patterns, and residual or salvage value, if any. Costs are allocated because: (1) the G-PP&E is expected to benefit more than one period and (2) generally, there is no other practical or efficient way to directly assign or associate cause (i.e., entity activity or event) and effect (i.e., service utility consumption). That is, depreciation is allocated, because specific causation cannot be ascertained.

A24. On the other hand, impairment occurs when there is a significant and permanent decline in the service utility during the depreciation period of G-PP&E remaining in use, and that decline is reasonably estimable in monetary terms. Essentially, an event or circumstance alters the utility and/or value of the asset such that the systematic and rational allocation process noted in paragraph A23 directly above can no longer be reasonably applied and must be also altered accordingly. Moreover, primarily due to the significant nature of the event or changed circumstances, an entity can directly assign or associate cause (the event or circumstance) and effect (change in anticipated utility and/or value of the asset). As a result, the lost or diminished service utility (arising from the impairment) can be directly assigned in a practical and efficient manner.

A25. To the extent that an entity's depreciation policies and practices reflect a pattern of service utility consumption that reasonably accounts for discrete events and/or changed circumstances, impairment losses may not apply. For example, if an entity operates in multiple climates within a country or maintains a global presence, its regular and on-going depreciation may account for lost or diminished service utility resulting from damages likely to arise from reasonably anticipated climate or other environmental conditions. This could be evidenced by an entity deriving its useful life estimates from current and historical fixed asset records or maintenance and repair accounts, which include such events and/or circumstances. In such cases, the entity might shorten the useful life estimate, alter the anticipated consumption pattern, or reduce its salvage value estimate. Consequently, depreciation would inherently consider the conditions giving rise to the impairment, thus avoiding the need to recognize an impairment loss.

Perceived costs versus benefits

A26. The Board believes that the benefits of implementing this Statement outweigh its administrative costs of implementation. The Board has clarified the Statement so that users understand that they are not required to search out impairments or to apply the Statement to immaterial items. Entities should consider G-PP&E impairments in the context of their existing practices and apply this Statement only when there is an indicator of significant impairment present. Although GASB, IPSASB, and FASB pronouncements are available to provide federal preparers with guidance relative to impairments, issuance of a Statement by FASAB will eliminate the need, time, and effort to search principles from another standard-setter or consider analogous entity transactions. Other perceived benefits include: reporting impairments when they occur rather than through depreciation expense or disposal, providing management with information useful for capital investment decisions, discerning the cost of impairments and impact on the entity and the cost of services provided following the impairment, and lastly, enhancing comparability between entities.

Summary of Outreach Efforts

A27. The Exposure Draft (ED), *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use,* was released on February 28, 2012, with comments requested by May 28, 2012.

A28. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A29. This broad announcement was followed by direct e-mailings of the press release to:

a. Relevant congressional committees: Senate Committee on Homeland Security and Governmental Affairs and House Committee on Oversight and Government Reform;

b. Public interest groups: The *Institute for Responsible Infrastructure Stewardship* and the *National Academy of Sciences' Federal Facilities Council*;

c. Respondents to SFFAS 42, *Deferred Maintenance and Repairs Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*.

A30. Twenty-three (23) responses were received. Table 1.0 summarizes responses by respondent type.

Table 1.0 - Summary of Respondent Types to Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	16	0	16
Users, academics, others	2	2	4
Auditors	2	1	3
Total	**20**	**3**	**23**

A31. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

A32. Respondents generally favored the Exposure Draft. By a 9-to-1 ratio respondents agreed with the Board's proposal to recognize impairment losses. Additionally, 22 of the 23 respondents agreed with the Board that entities are not expected to alter existing assessment methods as a direct consequence of this Statement. Some respondents offered suggestions that the Board adopted and revised the Exposure Draft accordingly. The most significant changes made to the proposed standards include: (1) simplifying the definition of impairment by not referencing either "gradual or sudden" and (2) clarifying entity reporting requirements. The most significant additions made to the Basis for Conclusions include (1) clarifying that recoveries take the form of exchange or non-exchange revenues and (2) a discussion concerning what distinguishes depreciation from impairment. Highlighted below are some respondent concerns that the Board decided to address.

Identifying Indicators of Potential Impairment

A33. Some respondents expressed concern over the indicators. Concerns ranged from the indicators being viewed as conclusive evidence of impairment necessitating an impairment loss test to the indicators being too vague and in need of expansion to address magnitude, permanence, and materiality. As stated at paragraph A7, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Furthermore, they are the first step in a two-step process and as a result cannot be deemed conclusive. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment may be unnecessary given the circumstances. Furthermore, as stated at paragraphs A6 through A9 in the section entitled *Common Indicators of Potential Impairment*, the paragraph 12 indicators are not meant to be definitive in nature nor a fully inclusive list. Therefore, management must exercise discretion and judgment when assessing potential impairment losses.

A34. Other respondents shared a concern that their auditors would require specific reviews or that the audit community could not determine the extent of additional audit procedures that could result from this Statement. The Board believes that this issue gets back to internal controls and processes. The Board is of the opinion that in most cases management would not have to apply additional or separate procedures to identify potential impairments. Rather, management might have to document (1) linkage to asset management systems (refer to paragraphs A4 and A5) that identify and communicate potential impairments and (2) materiality so that auditors would accept that the financial statements are presented fairly. At a minimum, management can be expected to document how it interprets and expects to apply this Statement.

Materiality

A35. Some respondents sought clarification concerning materiality. The Board has made clear that this matter depends on the degree to which omitted or missing information could influence a reasonable person's judgment and that this Statement is not to be applied to immaterial items. The Board notes two important matters in this regard. First, when assessing materiality management should consider the impact of the potential impairment to the entity's cost of service(s). It is not the Board's intent to direct application of this Statement to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Second, entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

Measurement

A36. Some respondents expressed concern over the measurement approaches. Concerns ranged from the approaches not being appropriate for real property asset classes to the Statement having too many methods from which to select. As stated at paragraphs 18 and A17, entities should use an approach that reasonably estimates the asset's diminished service utility. The Board has made clear that it seeks reasonable impairment loss estimates and is not prescribing any particular approach. Preparers are not restricted to the approaches shown at paragraph 18 and may use other approaches that accomplish the following two objectives: (1) reasonably estimate the diminished service utility and (2) reasonably estimate net book value associated with the remaining service utility.

G-PP&E Exemptions

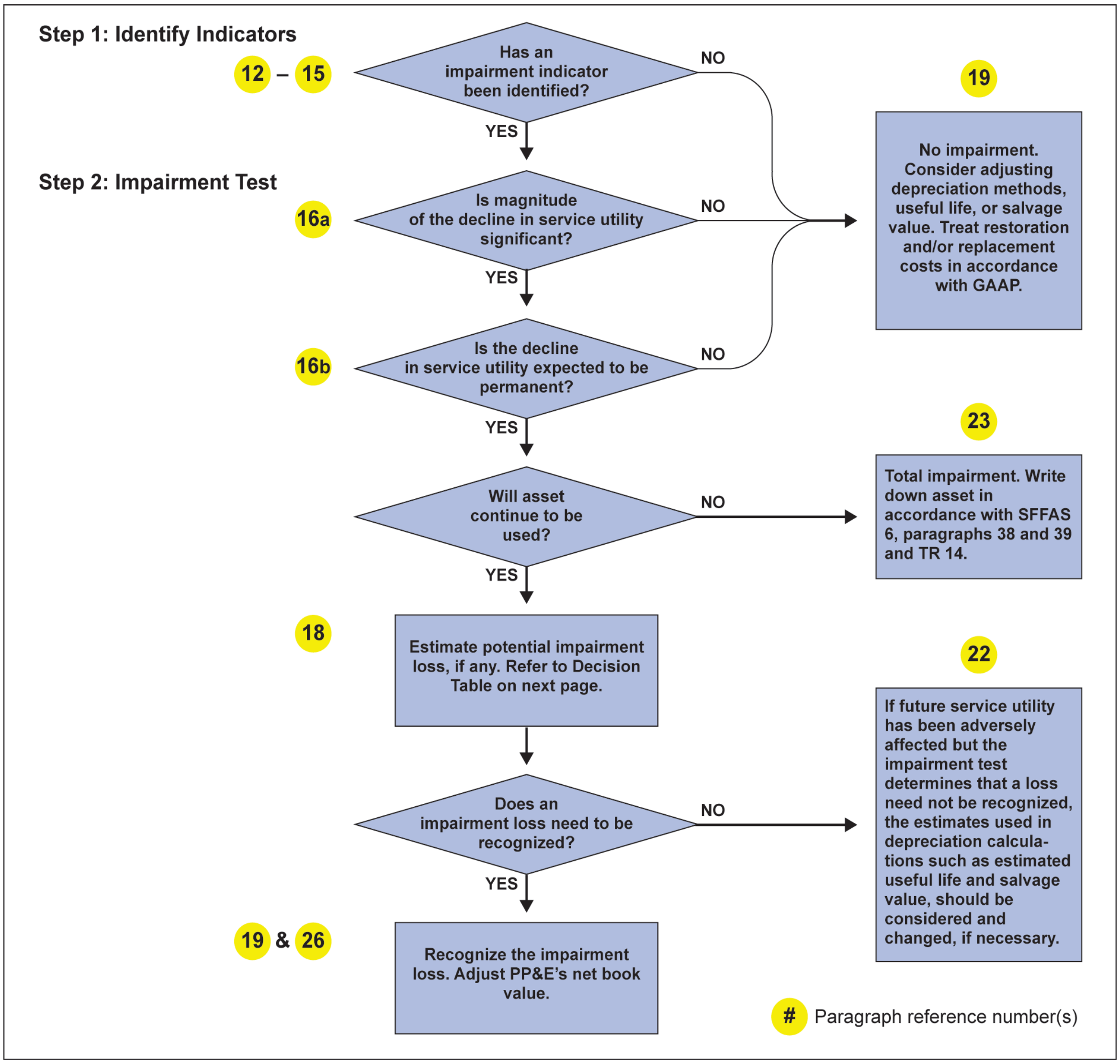
A37. Some respondents noted provisions of this Statement should not apply to certain G-PP&E categories, classes, or base units. The Board explored the respondents' rationales for seeking to waive the requirements and determined that no exemptions would be warranted. A careful reading and implementation of the Statement would preclude application of this Statement to some G-PP&E classes. Specifically, as stated at paragraph 8, the events or changes in circumstances that lead to impairments are not considered normal and ordinary. That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating the useful life. For example, in the case of military equipment "normal and ordinary" would come with the expectation that the G-PP&E would be responding to contingencies and entering into combat operations at some future time. As a result, lost service utility arising from such events or circumstances could not be considered unanticipated and would fall outside the realm of this Statement. Additionally, G-PP&E classified as mission critical will rarely be partially and permanently impaired as its service utility would generally be replaced or restored and if not, the asset would be removed from active service because it would no longer be mission capable.

A38. The Board notes that in those cases where an entity considers certain G-PP&E to be non-mission critical or immaterial, management can (1) read the views of the Board concerning materiality as detailed in paragraph A35 above, and (2) reevaluate its capitalization threshold and depreciation policies and procedures. For example, under the requirements of this Statement, office furniture and fixtures that have been capitalized could become impaired. However, management may determine that any resultant impact to its cost of service(s) would be immaterial. In such cases, an entity may elect to prospectively change its capitalization criteria and/or alter its depreciation policies.

Board Approval

A39. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Flowchart, Decision Table and Illustrations



Select a method that reasonably represents diminished service utility by considering potential indicators and type of PP&E.

If more than one method is reasonable, select the most efficient and practicable method.

Measurement Methods*	Potential Indicators	Type of PP&E **	Reference	Illustrations that may be appropriate
Replacement Approach	• Physical Damage	All G-PP&E	Par. 18 a	1c
Restoration Approach	• Physical Damage	Multi-use Heritage PP&E	Par. 18 b	2b
Service Units Approach	• Physical Damage • Enactment or approval of laws/regulations • Changes in environmental or economic factors • Technological changes or obsolescence	All G-PP&E	Par. 18 c	1d, 3a, 3b
Deflated Depreciated Current Cost Approach	• Change in manner or duration of use.	All G-PP&E	Par. 18 d	4a
Cash Flow Approach	• Any of the indicators as listed at Paragraph 12 (a through g)	Cash or Revenue Generating G-PP&E	Par. 18 e	7a, 7b, 7c, 7d
Lower of (1) Net Book value or (2) Higher of Net Realizable Value or Value-in-Use Approach	• Construction stoppage / Contract terminations	All G-PP&E	Par. 17 & 18 f	5, 6a, 6b, 7b

*Other industry-accepted methods may be appropriate

** = excluding internal use software

ILLUSTRATIONS

This remainder of this appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality; as such, estimated impairment losses are labeled as "potential" in each illustration because they would still require a further assessment as to whether the estimated loss is material and should be recognized. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards to ensure each situation is considered in the appropriate context.

Illustration 1a

Temporary Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination* [18]

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed. The mold remediation involves removing and rebuilding the interior walls and improving site drainage at a total cost of $4 million.

Management develops specific plans to begin remediation efforts as soon as possible and replace the lost service utility. In addition, funding has been identified and set-aside.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because management has specific plans to replace the lost service utility of the building and has identified and set-aside funding, there is reasonable expectation that the damage is temporary and no potential estimated impairment loss is recognized.

[18] Illustrations 1a through 1d have been adapted from GASB 42, Illustration 1, *Physical Damage – School with Mold Contamination*.

Illustration 1b

Complete Removal from Service: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

Due to the extent of the damage, management does not believe that remediation efforts will begin and that the lost service utility of the building is not temporary. As a result, management has decided to remove this building from service and prepare it for disposal.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no potential estimated impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 38 and 39 are applicable.

Illustration 1c

Replacement Approach - Permanent Declines in Service Utility: *Physical Damage to an Office Building due to an Earthquake*

Assumptions

In 2012, entity officials became aware of extensive masonry wall and building foundation damage at one of its office buildings as a result of a recent earthquake. The damage to the masonry walls was spread throughout the five-story building and the building foundation was damaged at non-critical vertical-load points. Facilities management personnel and engineers advised that despite a decline in service utility, the damaged building would still be capable of meeting reasonable, but reduced performance objectives in its damaged state, making major repairs and costly upgrading unnecessary. Limited and minor repairs, both cosmetic and structural, could be made to improve visual appearance and component damage at nominal cost. Facilities managers and engineers have estimated that the major repairs and upgrades (involving removal and rebuilding of the interior walls and improving site drainage) would cost $2 million.

After a detailed review, management decided to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million. Accumulated depreciation related to the building and to the improvements were $600,000 and $320,000, respectively.

Evaluation of potential estimated impairment loss

The masonry wall and building foundation damage is evidence of physical damage – an impairment indicator. Also, the magnitude of the decline in the lost service utility is significant because its remediation would involve major repairs and costly upgrades. Because management decides to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and engineers estimated that the major repairs and upgrades would have cost if incurred, $2 million. In accordance with the entity's capitalization policies, 10 percent of the remediation cost would be allocable to site clean-up and treated as a period expense, and 90 percent would be allocable to remediating the masonry wall and building foundation damage. As recorded in the entity's asset management system, the estimated plant replacement value (PRV) of the office building is $8.5 million.

Calculate Net Book Value			
	Historical Cost	Accumulated Depreciation, 2012	Net Book Value, 2012
Land	**$100,000**		**$100,000**
Building acquisition, 1982	$1,200,000	$600,000	$600,000
Improvements	1,235,000	320,000	915,000
Total - Building & Improvements	**$2,435,000**	**$920,000**	**$1,515,000**

Calculate estimated cost to replace lost service utility:	
Total remediation cost	$2,000,000
Percentage wall & foundation cost	90%
Wall & Foundation Remediation cost	**$1,800,000**

Calculate percentage of lost service utility in current dollars:	
Wall & Foundation Remediation (estimate of lost service utility in current dollars)	$1,800,000
Plant Replacement Value (estimate to replace building in current dollars)	$8,500,000
Wall & Foundation Remediation cost percentage	21.18%

Calculate potential estimated impairment loss:	
Net book value (historical cost)	$1,515,000
Multiplied by: Wall & Foundation Remediation cost percentage	21.18%
Potential estimated impairment loss	$320,877

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $320,877.

Illustration 1d

Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. The mold contamination in the walls of the building was limited to the top two floors of the five-story building and could be safely contained and encapsulated. Facilities management personnel advised that the first three floors of the building could continue to be safely used.

Management does not believe that the loss of service utility will impede their operations and consequently, do not plan to remediate the mold contamination. Management has decided to discontinue the use of the top two floors and commence containment and encapsulation efforts. The remainder of the building will be kept in service.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., contamination of two of the five floors of the building) is a significant decline in service utility. Because management does not plan to replace the lost service utility of these floors, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities management personnel in consultation with the Comptroller's office advise management to use the service units approach instead of the replacement cost approach because using construction cost estimates are not likely to result in a materially different potential estimated impairment loss amount. Management agrees to select the service units approach because it reasonably represents diminished service utility and given the circumstances, it is the most efficient and practicable method to use.

Calculate percentage of lost service utility in terms of units:	
Lost service utility in terms of floor units	2 floors
Total service utility prior to damage in terms of floor units	5 floors
Percentage of lost service utility in terms of units	40.00%

Calculate potential estimated impairment loss:	
Net Book Value (historical cost)	**$1,515,000**
Multiplied by: percentage of lost service utility - units	**40.00%**
Potential estimated impairment loss	$606,000

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $606,000.

Illustration 2a

Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset* [19,20]

Assumptions

Recent media reports have noted that acid precipitation (often called acid rain) is of increasing concern in the metropolitan area and, in particular to many of the area's historic and national landmarks including multi-use heritage assets. The entity's conservation scientists confirm the media reports and note that although normally rain is slightly acid, current rainfall has an average pH of more than 10 times normal levels.

[19] Illustration 2a adapted from: Department of the Interior, *Acid Rain in Washington*, http://pubs.usgs.gov/gip/stones/acid-rain.html.

[20] Heritage Assets are 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. Multi-use Heritage Assets are heritage assets whose predominant use is general government operations. FASAB Appendix E: Consolidated Glossary,

Limestone and marble, the stones that form many of the buildings and monuments in the metropolitan area are especially vulnerable to acid precipitation because they are predominantly made of the mineral calcite (calcium carbonate), which dissolves (i.e., erosion) easily in acid. Capitalized alterations made over the years to accommodate the heavy traffic brought about by administrative and visitor use of one of the more prominent multi-use heritage assets has drawn management's attention. The entity's Inspector General (IG) has begun a review and in an interim draft report has noted the following,

> "The marble balustrade on the south side, main entrance of the administrative building shows damage from acid rain posing a serious threat to the hundreds of visitors and employees who walk by this concourse daily. Management must take immediate corrective action in order to avoid potential bodily harm and liability."

Management in consultation with the conservation scientists and facilities managers determines that (1) erosion (deterioration caused by exposure to the environment) is a natural part of the normal geologic cycle and was reasonably expected to occur, and (2) temporary braces and steel under-girding currently in-place are sufficient for the current year. Management plans to restore the balustrade during the next fiscal year.

Evaluation of potential estimated impairment loss

The erosion is evidence of physical damage – an impairment indicator. Also, the prominence of the event (i.e., coverage by the media and the IG's recommendation) would be evaluated as a potential impairment indicator of significant loss in service utility. However, no potential estimated impairment loss is recognized because (1) the decline in lost service utility is "normal and ordinary" as it arises from a cyclical act of nature and (2) restoration efforts to cure the damage are planned to begin next fiscal year. Management should consider evaluating its depreciation policies and methods to reflect the adverse effect of the acid rain on buildings and monuments made of limestone and marble.

Illustration 2b

Restoration Approach - Permanent Declines in Service Utility: *Physical Damage to a Multi-use Heritage Asset*

Assumptions

A fire recently destroyed most of a three-story wing addition of an historic building. The building addition housed senior administrative offices. The foundation and portions of the first level were not seriously damaged and considered salvageable.

The Secretary’s proposal to the Board of Regents (Regents) requested a minimum of $4.5 million to restore the three-story administrative wing. The Regents questioned the reasonableness of the cost estimate noting that typical office building construction in the metropolitan area costs about $160.00 per square foot (psf). The Secretary advised that the $160.00 psf estimate was not appropriate to use because it represented a “replacement” estimate using today’s current labor, materials, standards and methods and not a “restoration” estimate that required using historically accurate materials and methods, as well as historic preservation and conservation methods as appropriate to preserve the historic nature and value of the multi-use heritage asset.

As an example, the Secretary noted the limited supply of the red Seneca sandstone used to construct the building in the 19th century and the added wing in the 20th century. The local quarry could only supply sufficient quantities to restore one level. As a result, complete restoration could not begin until a second quarry could be located to supply the additional quantities. Furthermore, experienced masons would have to be used for the restoration effort.

As a result of this information, the Regents modified the Secretary’s request to restore one level of the wing noting that subsequent levels should not be restored in the future and that no such plans should be undertaken nor should any monies be committed. Displaced staff was moved to nearby vacant office space.

Evaluation of potential estimated impairment loss

The destruction to the three-story wing is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., loss of senior administrative office space) would be evaluated as a significant decline in service utility. Because the Regents provided for partial restoration (one level) of the multi-use heritage asset, the lost service utility of the other two levels of the administrative wing is deemed permanent. As a result, because the lost service utility from these two levels is not reasonably expected to be restored, the potential estimated impairment loss is considered permanent and any resultant potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and reconstruction specialists have estimated that (1) the total remediation of the three-story wing would cost $4.5 million and (2) restoring the first level would cost $2.0 million. The net book value of the administrative portion of the building prior to the fire damage was $1.75 million. In accordance with the Restoration Approach, the following estimates and calculations were presented to management:

Calculate estimated cost to restore lost service utility:	
Total restoration cost (all 3 levels)	$4,500,000
Less: portion to be restored (first level)	$2,000,000
Cost to restore lost service utility (2nd and 3rd levels)	$2,500,000

Calculate percentage of restored lost service utility in current dollars:	
Cost to restore lost service utility of the 2nd and 3rd levels of the wing (estimate of lost service utility in current dollars)	$2,500,000
Total restoration cost (all 3 levels)	$4,500,000
Restoration cost percentage	**55.5**%

Calculate potential estimated impairment loss	
Net Book Value (historical cost of wing)	$1,750,000
Multiplied by: Restoration cost percentage	55.5%
Potential estimated impairment loss	**$971,250**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $971,250.

Illustration 3a

Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine* [21]

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the “closed” MRI system continues to be incurred and management is evaluating the asset’s continued service use and whether or not to book an impairment loss.

Upon inspection of the “closed” MRI system and closer examination of the related O&M costs, hospital administrators have determined that it is cost-beneficial to keep the system operational and that there is no impairment loss. They estimate that the system can be expected to last at least three years longer than originally estimated and achieve its expected service output. Furthermore, hospital administrators contend that a significant portion of the costs are (1) considered “sunk” due to the fixed-price nature of the long-term maintenance contracts and (2) fixed inasmuch as they will be incurred regardless of the closed MRI system’s operating levels.

Evaluation of potential estimated impairment loss

Management initially identified that the change in technology was an indicator of potential impairment because it had resulted in a permanent reduction in the usage of the “closed” MRI system. Also, they believed that the magnitude test (i.e., decline in service utility relative to operating costs) had also been met due to the fact that the cost of operating the “closed” MRI system has remained the same while the service provided has decreased to 60 percent of prior levels. However, management has concluded that there is no potential estimated impairment

[21] Illustrations 3a and 3b adapted from: GASBS 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine.*

loss (i.e., the MRI system did not meet Step 2 – Impairment test) because the asset can achieve its expected service output by being kept in service three years longer than originally planned. Using the service units approach, management determines the followings:

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	Net Book Value, 2013	**$1,285,714**

Calculate Acquisition cost per service unit		
a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	Acquisition cost per service unit (a divided by c) (rounded)	$124.00

Calculate Remaining Number of Service Units & Related Costs to be recovered:		
d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining number of service units = (4 years plus 3 extended years × 52 weeks per year × 5 days per week × 6 uses per day)	10,920
f	Remaining service costs to be recovered (d multiplied by e)	**$1,354,080**

Calculate Potential Estimated Impairment Loss:	
Net Book Value, 2013 (b)	**$1,285,714**
Remaining service costs to be recovered (f)	$1,354,080
Potential estimated impairment loss (b minus f)	**N/A**

Reporting Considerations

Although there is no potential estimated impairment loss to consider or recognize because the remaining service costs to be recovered is greater than the PP&E's net book value, management should consider re-evaluating its depreciation policies and methods to reflect the additional 3 years of extended service.

Illustration 3b

Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day; a decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn management’s attention to evaluate the asset’s continued service use.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the “closed” MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also been met due to the fact that the cost of operating the “closed” MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. Potential estimated impairment loss using the service units approach would be determined as follows:

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	**Net Book Value, 2013**	**$1,285,714**

Calculate Acquisition cost per service unit		
a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	Acquisition cost per service unit (a divided by c)	$124.00 (rounded)

Calculate Remaining Number of Service Units & Related Costs to be recovered:		
d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining service number of units = (4 years × 52 weeks per year × 5 days per week × 1 use per day)	1,040
f	Remaining service costs to be recovered (d multiplied by e)	$128,960

Calculate Potential Estimated Impairment Loss:		
	Net Book Value, 2013 (b)	**$1,285,714**
	Remaining service costs to be recovered (f)	$128,960
	Potential Estimated Impairment loss (b minus f)	**$1,156,754**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $1,156,754.

Illustration 4

Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*[22]

Assumptions

In 2013, management decided to close a training facility because enrollments declined due to outsourcing initiatives brought about as a result of Office of Management and Budget (OMB) Circular No. A–76, *"Performance of Commercial Activities."* The closed training facility has been converted for use as a storage warehouse.

This training facility was constructed in 2001 at a cost of $10 million. The estimated useful life of the facility is fifty years. Entity management has (1) no evidence that enrollments will increase in the future such that the building would be reopened for use as a training facility and (2) concerns with the significantly high operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc.

Because no physical damage occurred that would require detailed cost repair estimates, management decides to use the deflated-depreciated current cost approach to measure the potential estimated impairment loss. Facilities managers have been able to readily identify current plant replacement value (PRV) for a comparable warehouse of the same size as $4.2 million and commercial construction indices of 100 and 150 for years 2001 and 2013, respectively.

Evaluation of potential estimated impairment loss

Impairment is indicated because the manner of use of the training facility has changed from training students to storage. The situation passes the magnitude test (i.e., decline in service utility relative to operating costs) because the ongoing costs of the training facility would likely be considered high in relation to the benefit it is providing - storage. Potential estimated impairment loss using the deflated depreciated current cost approach would be determined as follows:

[22] Illustration 4a adapted from: GASB 42, Illustration 5, *Change in Manner or Duration of Use – School Used for Storage.*

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
	Historical cost, 2001	$10,000,000
	Accumulated depreciation (12 / 50 years)	2,400,000
a	**Net Book Value, 2013**	**$7,600,000**

Calculate Depreciated current cost (current dollars)		
	Replacement cost of warehouse, 2013	$4,200,000
	Accumulated depreciation (12 / 50 years)	1,008,000
b	**Depreciated current cost**	**$3,192,000**

Calculate Deflation factor:		
c	Commercial construction index, 2001	100
d	Commercial construction index, 2013	150
e	**Deflation factor (c divided by d)**	**0.67**

Apply deflation factor to depreciated current cost		
b	Depreciated current cost	$3,192,000
e	Deflation factor (c divided by d)	0.67
f	**Deflated depreciated current cost (b × e)**	**$2,138,640**

Calculate Potential estimated impairment loss:		
a	Net Book Value, 2013	$7,600,000
f	Deflated depreciated current cost (b × e)	2,138,640
	Potential estimated impairment loss (a - f)	**$5,461,360**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $5,461,360.

Illustration 5

Construction Stoppage—*Special Purpose Test Equipment* [23]

Assumptions

In 2012, in response to a Congressional order canceling a major program, management stopped all construction activities related to the fabrication of program-related special purpose test equipment. The entity conducts numerous design and build projects for military and scientific purposes all of which have potential commercial application. The entity's program manager advised management that the special purpose test equipment was substantially complete at the time of stoppage and could be considered available for commercial use. The entity had accumulated costs totaling $10 million and was approximately 75 percent complete with the project.

Upon further inquiry, management determined that despite initial interest from two commercial firms, early in 2012, one of them filed for bankruptcy and the other withdrew its interest citing that the costs-to-complete are too high. There is no evidence to demonstrate that the construction stoppage is temporary or that other potential commercial interests can be found. Also, the program manager advises that there is no potential government use for this asset and that it should be disposed.

Evaluation of potential estimated impairment loss

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or $10 million) are significant in both percentage and monetary terms. However, there is no potential estimated impairment loss to report in accordance with this standard because the asset is totally impaired as it has no commercial or government use and cannot provide service. As such, the requirements in SFFAS 6, paragraph 38[24] should be followed. Specifically, in the period of disposal accumulated costs should be

[23] Illustration 5 adapted from: GASB 42, Illustration 9, *Construction Stoppage—Airport Pavements.*

[24] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

removed from the asset accounts and any difference between the book value of the equipment and amounts realized shall be recognized as a gain or a loss.

Illustration 6a

Contract Termination - *Transferable Equipment Technology*

Assumptions

In 2012, the entity's chief contracting officer terminated a contract pursuant to the Federal Acquisition Regulations because the entity experienced substantial cost increases, schedule delays, and performance shortfalls. The terminated contract was to build the entity's next-generation surveillance equipment capable of covertly operating in adverse weather conditions. Despite several cure notices, the entity terminated the contract for default. The contractor has stated that it will not protest the termination. At the time of termination, the entity had incurred $150 million in contract costs.

In the meantime, the program manager determined that the operating environment had changed and that remaining funds would be better spent on other priorities and was able to transfer the system technology to other entity projects. The manner and use of the systems are not expected to change.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the event is significant and the termination decision will not be protested; i.e., permanent. However, because the entity was able to transfer the system technology to other entity projects, no potential estimated impairment loss exists.

Illustration 6b

Contract Termination - *Partially-Transferable Equipment Technology*

Assumptions

Same assumptions used in Illustration 6a except that the program manager was unable to transfer the entire system technology to other entity projects. After an inspection and engineering review, it was determined that 70 percent of hardware and software could be transferred to existing projects. There is no potential use or application for the remaining 30 percent of equipment technology.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the termination decision is a significant event and is considered permanent because the decision will not be protested. As a result of the entity being unable to transfer the entire system technology to other entity projects, an impairment exists.

Measurement of potential estimated impairment loss

Because 30 percent of the system technology cannot be transferred to other entity projects, a potential estimated impairment loss of $45 million exists (30.0% X $150 million).

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $45 million.

Illustration 7a

Cash flow approach – *Grouped Assets*

Assumptions

An entity manages and operates a shared-services center on a post-wide basis that provides administrative and information technology support. The entity groups the individual services separately into two distinct categories rather than on an individual basis. The net book values are $12 million and $11 million for the administrative and information technology (IT) groups, respectively.

In December 2012 the entity's management decided to implement a public-private strategic initiative that could eventually over several years transition these shared-services operations to private ownership. Both national and local private interests have asked their respective political representatives to accelerate the entity's implementation time-table and influence a favorable outcome. Management was directed to (1) immediately estimate the amount that could be recovered from selling the operations and (2) identify to the lowest level identifiable, operating information to include cash flows for each category. An appraisal was conducted to ascertain the amount that could be recovered from selling each of the groups. The appraisal report noted (1) that net realizable value (NRV) amounts were greater than value-in-use estimates and (2) the

NRV amounts of $13 million and $8 million for the administrative and IT groups, respectively. The Chief Financial Officer identified the following cash flow information: (a) cash from continuing operations of $12 million and $9 million for the administrative and IT groups, respectively and (b) cash flows from disposal activities of $2 million and $1 million for the administrative and IT groups, respectively.

As a result of complying with this directive and evaluating the resultant financial information and appraisal analysis, management became concerned that its assets might be impaired and adversely impact its public-private strategic initiative.

Evaluation of potential estimated impairment loss

If an impairment indicator exists, an impairment analysis should be considered. In this case, the entity's public-private initiative includes a significant change in the manner or duration in which the assets will be used. This represents an impairment indicator that would trigger an impairment analysis. Furthermore, management's concern that its assets might be impaired passes the magnitude test.

Management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. To apply the cash flow approach, the entity will need to estimate the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The future cash flows are the expected cash inflows to be generated by the asset net of any expected future cash outflows that are needed to produce the inflows.

Measurement of potential estimated impairment loss

This approach requires that an entity recognize a potential estimated impairment loss if (1) the undiscounted cash flows are less than the net book value of the assets (the net book value is not recoverable) and (2) the net book value exceeds the higher of the assets NRV [25] or value-in-use estimate.[26] A potential estimated impairment loss would be measured as the amount by which the net book value of the grouped assets exceed the higher of their net NRV or value-in-use estimate(s).

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[25] Net realizable value is 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. Source: FASAB Glossary, Appendix E.

[26] Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, at paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

When identifying cash flows, assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets

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Calculate Net book value:		
Net book value:	**Asset Group: Administrative**	**Asset Group: IT**
Assets' net book values at 12/31/2012 (a)	**$12,000,000 (a)**	**$11,000,000 (a)**
Calculate undiscounted cash flows		
Undiscounted cash flows from future operations	$12,000,000	$9,000,000
Undiscounted cash flows from future disposal of assets	2,000,000	1,000,000
Total - undiscounted cash flows (b)	**$14,000,000 (b)**	**$10,000,000 (b)**
Calculate Recoverability:		
Recoverability: (b minus a)	**Asset Group: Administrative**	**Asset Group: IT**
Total - undiscounted cash flows (b)	**$14,000,000**	**$10,000,000**
Assets' net book values at 12/31/2012 (a)	**12,000,000**	**11,000,000**
Recoverability (b minus a)	**$2,000,000**	**$(1,000,000)**
Is net book value recoverable?	Yes	No
Is asset subject to potential impairment?	No	Yes

Calculate potential estimated impairment loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable **and** (2) exceeds the higher of its net realizable value or value-in-use estimate. Because the administrative group has undiscounted cash flows greater than related net book values, recoverability is met and there is no potential impairment. However, because the IT group has undiscounted cash flows lower than related net book values, recoverability is not met and the potential for impairment exists. The calculation below shows that a $3 million potential estimated impairment loss exists because the $11 million net book value of the IT group's G-PP&E exceeds the higher of its net realizable value or value-in-use estimate (in this case we are told that the $8 million NRV amount is higher than the value-in-use estimate).

Potential estimated impairment loss:	**Asset Group: Administrative**	**Asset Group: Information Technology**
Net Realizable Value of assets at 12/31/2012	N/A	$ 8,000,000
Less: Assets' net book values at 12/31/2012	N/A	**$11,000,000**
Excess of net book value over Net Realizable Value	N/A	**$3,000,000**
Potential estimated impairment loss	N/A	**$3,000,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the IT asset group is $3.0 million.

Illustration 7b

Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*[27]

Assumptions

In 2009, a hospital operating in a major metropolitan area purchased a "closed" magnetic resonance imaging (MRI) system at a cost of $2.25 million to be used exclusively for non-service

[27] Illustration 7b adapted from: GASB 42, Illustration 4, *Technological Development or Evidence of Obsolescence - Underutilized Magnetic Resonance Imaging Machine.*

connected procedures. The hospital, which charges fees for non-service connected care estimated that the system would have an estimated useful life of seven years and that on average the system would be used for twenty tests per day for five days per week. The average user fee for MRI services is $20.00 per use. Shortly after installation, utilization levels dropped to ten tests per day because of reduced demand for the services attributable to the “closed” nature of the MRI system.

In 2012, the manufacturer introduced an “open” MRI system that was advertised as being more comfortable for patients and provided a superior image. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn management’s attention to evaluate the asset’s continued service use. Because similarly used MRI machines in the open market can be purchased from authorized dealers for $750,000 (their mark-up percentages are unknown), management is considering the possibility of selling the old machine and using its proceeds to help purchase the “open” MRI system.

Hospital administrators and technicians believe that the “closed” system can continue being used at the current utilization level for at least 3 years beyond the originally estimated service life. Also, they believe that the “open” system provides for only marginal benefits that do not exceed their cost. In light of this information, management decides not to sell the “closed” system. However, because the service utility expected at acquisition (20 tests per day) can no longer be achieved and is accompanied by an underlying cause; reduced demand arising from the less comfortable “closed” system, a potential impairment loss exists.[28]

Evaluation of potential estimated impairment loss

The indicators of potential impairment are (1) the change in technology and (2) reduced demand accompanied by an underlying cause; the less comfortable “closed” system. The magnitude test has also been met due to the fact that the cost of operating the “closed” MRI system has drawn management’s attention to evaluate the asset’s continued service use. Potential estimated impairment loss using the cash flow approach would be determined as follows:

[28] It is important to note that (1) the reduced demand alone is not a discrete or sole indicator of impairment and (2) technological changes or obsolescence should be considered along with other factors when assessing impairment. Regarding the former, had there been no underlying potential impairment (refer to the paragraph 12 indicators), no impairment test would have been required. Concerning the latter, had the utilization level (20 tests per day) and remaining service life (3 years) of the equipment stayed the same, no impairment test would have been required because the equipment’s service utility that was expected at acquisition would be deemed recoverable.

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2009	$2,250,000
	Accumulated depreciation, 2012 (3 / 7 years)	964,286
b	**Net Book Value, 2012**	**$1,285,714**

Calculate undiscounted cash flows:		
c	Average service fee per use	$20.00
d	Remaining service units (4 years plus 3 extra years × 52 weeks per year × 5 days per week × 10 use per day)	18,200
e	**Undiscounted cash flows (c multiplied by d)**	**$364,000**

Calculate Recoverability: (b minus a)		
		MRI
	Total - undiscounted cash flows (e)	$364,000
	Asset's net book values at 9/30/12 (b)	$1,285,714
	Recoverability (e minus b)	**$(921,714)**

Is Net book value Recoverable?	No
Is asset subject to potential impairment?	Yes

Calculate Potential Estimated Impairment Loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value or value-in-use estimate. Because management believes that the open market price of $750,000 is a reasonable estimate of the asset's net realizable value, it is compared to the asset's value-in-use estimate to determine which amount is higher. However, because the $364,000 undiscounted cash flows amount (prior to calculating the net present value to determine a value-in-use estimate) is lower than net realizable value amount of $750,000, there is no need to present value the cash flows to calculate a value-in-use estimate.

Because management believes that the open market price of $750,000 is a reasonable estimate, it is used as the “recoverable basis”. Had the net realizable value estimate been unavailable to management, a value-in-use estimate (net present value of the future cash flows) could have been used as the “recoverable basis”.

	MRI
Net Realizable value of asset	$750,000
Less: Asset’s net book value	$1,285,714
Excess of net book value over fair value	**$ (535,714)**
Potential estimated impairment loss	**$ (535,714)**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $535,714.

Illustration 7c

Cash flow approach – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[29]

Assumptions

An entity operates a government owned-contractor operated (GOCO) manufacturing facility in an economically depressed area fabricating various commodities with commercial applicability. The facility’s current net book value is $22,500,000 with an estimated salvage value of $5,000,000 and has a 25 year estimated remaining useful life. Under the terms of the contract, the government provides the contractor with exclusive use of the facility in exchange for negotiated lease payments in the amount of $150,000 per year. The contractor is responsible for all maintenance and operating costs.

Recently this unique partnership has come under federal and state scrutiny as many legislators and environmentalists have expressed concerns that the contractor whose operations have caused contamination found in and around the facility is not being held financially responsible for the cleanup costs.

[29]Illustration 7c adapted from: Military Law Review, Volume 131 Winter 1991; - Government Owned – Contractor Operated Munitions Facilities*: Are they appropriate in the age of strict environmental compliance and liability?;* Major Mark J. Connor.

Outrage which has surfaced during congressional hearings on environmental cleanups has become the focus of print and cable-news outlets.

Further complicating management's "crisis response" is that (1) the contract effectively prohibits modifying the facility to achieve greater environmental compliance without legislative relief and (2) the contracting officer has initiated debarment procedures that effectively would shut down the facility in 90-days for an indeterminable amount of time.

Facilities managers and engineers believe that a prospective buyer can be found but that it will take significant time to pass all necessary sale requirements. Until then, they advise that the facility can be quickly reconfigured and partitioned into commercially viable long-term storage space. The required modifications would cost $500,000 and lease agreements are estimated to generate approximately $35,000 in annual revenues. A fairly recent analysis completed 9 months ago reveals that the property's net realizable value (NRV) was at that time, $30,000,000; 20 percent of which is attributable to land.

Management has approved the reconfiguration and partition plan and believes that it will take a minimum of 5 years before all approvals are in place and disposal efforts can begin and an additional 2 years to ultimately dispose of the property. Because management is concerned with the proper financial reporting of this event, it has asked its comptroller for advice.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in manner of use. The magnitude test has also been met due to (1) federal and state scrutiny, (2) media coverage, and (3) the fact that the cost of operating the facility has drawn management's attention to evaluate the asset's continued service use and seek the comptroller's advice. Because the entity is seeking appropriate approvals to commence disposal efforts and does not know when such permission will be granted, management intends to convert a portion of the facility for public storage; a change in the manner of use.

Measurement of potential estimated impairment loss

Calculate Net book value:	Facility
Assets' net book value at 12/31/X1 (a) (excluding land)	**$22,500,000 (a)**

Calculate undiscounted cash flows	
Required modifications (outflow)	($500,000)
Undiscounted cash in-flows from future rental lease payments (7 x $35K)	$245,000
Undiscounted cash in-flows from disposal of assets (1.0 -0.2 X $30Mil)	24,000,000
Total - undiscounted cash flows (b)	**$23,745,000 (b)**

Calculate Recoverability: (b minus a)	Facility
Total - undiscounted cash flows (b)	**$23,745,000**
Assets' net book values at 12/31/X1 (a)	**22,500,000**
Recoverability (b minus a)	**$1,245,000**
Is Net book value Recoverable?	**Yes**
Is asset subject to potential impairment?	**No**

Reporting Considerations

There is no potential estimated impairment loss to consider or recognize because the undiscounted cash flows to be recovered are greater than the G-PP&E's net book value.

Illustration 7d

Cash flow Approach (Calculating value-in-use using discounted cash flows) – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[30]

Assumptions

Same facts as Illustration 7c above except that (1) management has decided to reconfigure the facility and lease available storage space for the remaining life of the facility, (2) the net realizable

30 Adapted from: Military Law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

value estimate is $2 million, and (3) the salvage value is $500,000. Furthermore, because management does not believe that a prospective buyer can be found it decides not to seek disposal authority. The entity's comptroller advises management that to assess whether or not a potential impairment exists a value-in-use estimate would be appropriate to use because it is higher than the net realizable value estimate. A risk-free discount rate of 3 percent is used.

Evaluation of potential estimated impairment loss

In this case the entity should (1) use the undiscounted cash flows to calculate recoverability and (2) present value (i.e., discount) the undiscounted cash flows to calculate the value-in-use estimate. In so doing, a potential estimated impairment loss is realized. Calculations follow:

Calculate cash flows:			
	Undiscounted	**PV Factor**	**Discounted**
Required modifications (outflow)	($500,000)	1.00	($500,000)
Undiscounted cash in-flows from future rental lease payments (25 x $35K)	$875,000	17.41315	$609,460
Undiscounted cash in-flows from disposal of assets)	$500,000	0.47761	$238,805
Total - cash flows (b)	**$875,000**		**$348,265**

Calculate Recoverability: (b minus a)	
Recoverability: (b minus a)	**Facility**
Total - undiscounted cash flows (b)	**$875,000**
Assets' net book values at 12/31/X1 (a)	**22,500,000**
Recoverability (b minus a)	**($21,625,000)**
Is net book value recoverable?	**No**
Is asset subject to potential impairment?	**Yes**

Calculate potential estimated impairment loss:	
Potential impairment:	**Facility**
Higher of NRV or Value-in-Use: NRV = $2,000,000 (given) Value-in-Use = $348,265 (discounted Cash Flows)	
Use the higher - Net Realizable Value	**$2,000,000**
Less: Assets' net book value at 12/31/X1	**$22,500,000**
Excess of net book value over recoverable value (in use)	**$20,500,000**
Potential estimated impairment loss	**$20,500,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $20,500,000.

Appendix C: Abbreviations

ASC	Accounting Standards Codification (FASB)
CFR	Consolidated financial report of the U.S. government
DM-AI	Deferred Maintenance and Asset Impairment (task force)
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GASBS	Governmental Accounting Standards Board Statement
G-PP&E	General property, plant, and equipment
IG	Inspector General
IPSASB	International Public Sector Accounting Standards Board
IPSAS	International Public Sector Accounting Standards
IT	Information technology
MRI	Magnetic resonance imaging
NRV	Net realizable value
O&M	Operation and maintenance
OMB	Office of Management and Budget
PP&E	Property, plant and equipment
PRV	Plant replacement value
psf	Per square foot
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 45: Deferral of the Transition to Basic Information for Long-Term Projections (Rescinded)

Status

Issued	July 8, 2013
Effective Date	Effective upon issuance.
Affects	SFFAS 36, par. 45
Affected by	SFFAS 46 rescinded SFFAS 45.

SFFAS 46, *Deferral of the Transition to Basic Information for Long-Term Projections - Amending SFFASs 36 and 45* rescinded SFFAS 45.

Statement of Federal Financial Accounting Standards 46: Deferral of the Transition to Basic Information for Long-Term Projections - Amending SFFASs 36 and 45

Status

Issued	October 17, 2014
Effective Date	Effective upon issuance
Affects	• SFFAS 36, par. 45 • SFFAS 45 is rescinded
Affected by	None.

Summary

This Statement provides a second one-year deferral of the transition of the statement presenting long-term fiscal projections for the U.S. government and related disclosures from required supplementary information (RSI) to basic information. Basic information is the information that is deemed essential for the financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP). RSI is information that a body that establishes GAAP requires to accompany basic information. While both categories of information are required, the auditor subjects the two categories of information to different procedures and complies with different reporting requirements under generally accepted government auditing standards (GAGAS).

This second deferral permits:

- the audit community to complete its consideration of the need for revised guidance, and
- the preparer time to plan for the audit.

During the deferral period, the consolidated financial report of the U. S. government will continue to report as RSI the information necessary for the reader to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Deferral of the transition to basic information provides an additional year for the American Institute of CPAs (AICPA) to develop guidance for audit reports on long-term fiscal projections.

Table of Contents

Introduction

Purpose

1. This Statement amends the effective date of the phased implementation first established in Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Projections for the U.S. Government* and later amended by SFFAS 45, *Deferral of the Transition to Basic Information for Long-Term Projections*. When fully implemented, SFFAS 36 requires a basic financial statement in the consolidated financial report of the U.S. Government (CFR), disclosures, and related required supplementary information (RSI). To allow a phased implementation, a three-year transition period was provided during which all information was RSI. The transition period was deferred one-year from the originally planned effective date of fiscal year (FY) 2013 to FY 2014.

2. SFFAS 36, as amended, requires information to be presented as follows in FY 2014:

    a. The basic financial statement would present for all activities:

        i. the present value of projected receipts and non-interest spending under current policy without change,

        ii. the relationship of these amounts to projected Gross Domestic Product (GDP), and

        iii. changes in the present value of projected receipts and non-interest spending from the prior year.

    b. Disclosures would explain and illustrate:

        i. the assumptions underlying the projections,

        ii. factors influencing trends, and

        iii. significant changes in the projections from period to period.

    c. RSI would explain and illustrate the projected trends in:

        i. the relationship between receipts and spending,

        ii. deficits or surpluses,

        iii. Treasury debt held by the public as a share of GDP,

        iv. possible results using alternative scenarios, and

v. the likely impact of delaying corrective action when a fiscal gap exists.

3. This Statement amends the transition period provided in SFFAS 36, as amended, to allow one additional year – FY 2014 – during which all of the above information would be reported as RSI.

Materiality

4. 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.

Standards

Scope

5. This Statement applies to the consolidated financial report of the U.S. Government (CFR).

6. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Projections for the U.S. Government*, and SFFAS 45, *Deferral of the Transition to Basic Information for Long-Term Projections,* to defer full implementation of its requirements by one year.

Amendments

7. SFFAS 45 is rescinded.

8. Par. 45 of SFFAS 36 is replaced by the following:

(45) The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2014.

a. These standards are effective for periods beginning after September 30, 2009.
b. Information should be reported as RSI for the first five years of implementation (fiscal years 2010, 2011, 2012, 2013, and 2014).

c. Beginning in fiscal year 2015, the required information should be presented as specified in paragraphs 12 - 42.
d. Earlier implementation is encouraged.

Effective Date

9. The requirements of this Statement are effective upon issuance.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. Inclusion of audited long-term fiscal projections in U. S. federal government financial reports began in fiscal year 2006 with the statement of social insurance. A number of individual programs provide a statement of social insurance including Social Security and Medicare. In 2009, the Board issued SFFAS 36 and broadened requirements for long-term fiscal projections beyond these discrete social insurance programs. SFFAS 36 requires comprehensive projections for all government receipts and expenditures and the OMB prepares these projections.

A2. The Board recognized the uncertainty inherent in making the policy, economic, and demographic assumptions necessary for comprehensive projections. The standards, therefore, provide for the exercise of judgment in selecting assumptions and require information to aid the reader in understanding and considering uncertainty and alternative outcomes. The audit community has been considering the need to revise the audit guidance, including initial guidance developed for the statement of social insurance, to address such comprehensive projections.

A3. In 2012, the American Institute of CPAs (AICPA) Auditing Standards Board (ASB) organized the Prospective Information Task Force to consider the auditor's responsibility for prospective financial information. The Board provided a one-year deferral to allow time for the task force to develop guidance. The task force has been considering guidance for auditors and appropriate audit report language regarding the statement of long-term projections, the statement of social insurance, and the statement of changes in social insurance amounts. Final guidance is expected to be issued in 2014 or early 2015.

Additional time will be needed for the preparer and the auditor to plan for the audit based upon the final guidance.

A4. Therefore, the Board proposed an additional one-year deferral of the transition of long-term fiscal projections from RSI to basic information is warranted. The Board released an exposure draft (ED), entitled *Deferral of Transition to Basic Information for Long-Term Projections: Amending SFFASs 36 and 45*, on April 30, 2014, with comments requested by June 2, 2014.

Responses to the Proposal

A5. The Board received 12 responses to the exposure draft. Of these responses, five were from non-federal organizations or individuals, five from federal chief financial officer organizations, and two from federal offices of inspectors general. One respondent indicated the organization had no comment on the proposal. Three non-federal respondents objected to the proposal and the remaining respondents supported the proposal.

A6. The Board considered responses to the exposure draft at its June 25, 2014, public meeting. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' views 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.

A7. Respondents opposed to deferring the transition to basic information noted the importance of the information to citizens as well as the time already provided for development of audit guidance. The Board considered the importance of the information when developing the proposal. In making its decision, the Board weighed the need for appropriate audit guidance and for time to plan for an audit under that guidance against the effect of a one-year delay. Because the information has been and will continue to be provided as RSI, the Board decided to provide the deferral. Thus, even with the deferral, the information will continue to be available and subject to the existing auditing standards related to RSI (see Appendix B for more information about audit considerations).

Board Approval

A8. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

Appendix B: Audit Considerations regarding Basic Information and RSI

This summary table serves as an aid to the reader in understanding the implications of the proposed deferral. It is not complete as it does not present in detail the auditing standards established by the American Institute of CPAs.

	Basic Information	RSI
Is the information required to be in the federal financial report? Source: FASAB, Statement of Federal Financial Accounting Concepts (SFFAC) 2, Entity and Display, par. 73C and AICPA Auditing Standards as Clarified (AU-C) 730.04	Yes	Yes
Is the information deemed essential if the financial statements are to “present fairly” in conformity with GAAP? Source: FASAB SFFAC 2, par. 73B and 73C, and AICPA AU-C 730.04	Yes	No

	Basic Information	RSI
What are the objectives of the auditor regarding basic information and RSI?	The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements. …As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (AICPA, AU-C 200 .04 and 200.06)	The objectives of the auditor when a designated accounting standard setter requires information to accompany an entity's basic financial statements are to perform specified procedures in order to a. describe, in the auditor's report, whether required supplementary information is presented and b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standard setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standard setter. (AICPA, AU-C 730.03)
What audit fieldwork is required?	Audit procedures in accordance with applicable auditing standards and requirements.[a]	Limited procedures pursuant to AU-C 730.05-.06.

	Basic Information	RSI
What is to be provided in the auditor's report?	When expressing an unmodified opinion on financial statements, the auditor's opinion should state that the financial statements present fairly, in all material respects, the financial position of the entity as of the balance sheet date and the results of its operations and its cash flows for the period then ended, in accordance with the applicable financial reporting framework. Also, the auditor's opinion should identify the applicable financial reporting framework and its origin. (AICPA AU–C Section 700.35 and .36)	Statement that the auditor has applied certain limited procedures and a statement that the auditor does not express an opinion or provide assurance on the information. (AICPA, AU-C 730-.08-.09)

	Basic Information	RSI
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Include a Basis for Modification Paragraph in the Report: If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should so state in the basis for modification paragraph. (AICPA AU-C 705.18) If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor should include in the basis for modification paragraph an explanation of how the disclosures are misstated. (AICPA AU-C 705.19) If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should describe in the basis for modification paragraph the nature of the omitted information; and include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (AICPA AU-C 705.20) Modify the Auditor's Opinion: A qualified opinion states that except for the effects of the matter(s) described in the basis for qualified opinion paragraph, the financial statements are presented fairly, in all	Include a statement that management has omitted the information and the information is required and is an essential part of financial reporting. Also, the auditor would state that the opinion on the basic financial statements is not affected by the missing information. (AICPA AU-C 730.08e) In addition, if the measurement or presentation of the information departs materially from the prescribed guidelines, the auditor would state that although the opinion on the basic financial statements is not affected, material departures from the prescribed guidelines exist and the auditor would describe the departures. (AICPA AU-C 730.08f)

	Basic Information	RSI
	material respects, in accordance with the applicable financial reporting framework. (AICPA AU-C 705.24) An adverse opinion states that the financial statements are not presented fairly in accordance with the applicable financial reporting framework. (AICPA AU-C 705.25)	

Source: The Federal Accounting Standards Advisory Board developed this summary but does not establish audit standards. For guidance regarding auditing standards, please refer to the source documents identified in the summary.

[a]The phrase “applicable auditing standards and requirements” is used to refer to auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

Appendix C: Abbreviations

AICPA	American Institute of Certified Public Accountants
ASB	Auditing Standards Board
AU-C	Auditing Standards - Clarified
CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal year
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Governmental Accountability Office
GDP	Gross Domestic Product
OMB	Office of Management and Budget
RSI	Required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Statement of Federal Financial Accounting Standards 47: Reporting Entity

Status

Issued	December 23, 2014
Effective Date	For periods beginning after September 30, 2017. Earlier implementation is not permitted.
Affects	SFFAC 2, par. 2-7, 10, 18, 29, 38-53, and 78.
Affected by	None.

Summary

This Statement establishes principles to include organizations for which elected officials are accountable in general purpose federal financial reports (GPFFRs). The principles guide financial reporting to recognize the complex diverse organizations possessing varying legal designations (for example, government agencies, not-for-profit organizations, corporations) that are used to address public policy challenges. The principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes. Rather, the principles guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity's GPFFR for financial accountability purposes.

The government-wide GPFFR should include all organizations (1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits. In addition, this Statement establishes that an organization be included in the government-wide GPFFR if it would be misleading to exclude it even though it does not meet one of the three inclusion principles. When any of these conditions exists, information regarding the organization is necessary to provide accountability.

This Statement provides for determining the most appropriate means—consolidated financial statements or disclosures—to include information about these organizations in GPFFRs. Determining the most appropriate means requires an assessment of the degree to which the following characteristics are met: the organization is financed by taxes or other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards on the federal government, and/or provides goods and services on a non-market basis. Note, however, not all characteristics are required to be met to the same degree; classification is based on the assessment as a whole.

Generally, consolidated financial statements presenting the financial position and results of operations are appropriate for those organizations that are to a large degree financed by taxes and other non-exchange revenue, governed by elected officials, imposing risks and rewards on the federal government, and providing goods and services on a non-market basis. Consolidated financial statements present the financial information as if the organizations were a single economic entity. Such a presentation is needed to show-–in

the aggregate—the net cost financed by taxes and other non-exchange revenue, the assets available for use, and the liabilities to be settled in the future. Organizations to be consolidated in the consolidated financial statements within the GPFFR are referred to as “consolidation entities.” Consolidation entities should apply Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Some organizations that meet the principles for inclusion are to a large degree insulated from political influence and not intended to be funded primarily by taxes and other non-exchange revenue. Presenting information about these discrete organizations in consolidated financial statements would obscure the operating results and financial position of the reporting entity. Instead, information about these types of discrete organizations should be disclosed in notes to the consolidated financial statements of reporting entities applying federal financial accounting standards. The disclosures should reveal the nature of the relationship to the reporting entity, relevant activity during the reporting period, and the reporting entity’s future exposures to risks and rewards resulting from the relationship. Organizations to be disclosed in the GPFFR are referred to as “disclosure entities.” While the hierarchy of generally accepted accounting principles (GAAP) established for federal reporting entities may not necessarily apply to disclosure entities; information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

This Statement establishes that each component reporting entity’s GPFFR include all organizations for which it is accountable. This includes all consolidation entities and disclosure entities administratively assigned to it. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs including information regarding disclosure entities.

In addition to the relationships that lead to organizations being included in the GPFFR based on the principles described above, the federal government may have significant relationships with other parties. This Statement requires disclosures if one party to an established relationship has the ability to exercise significant influence over the other party in making policy decisions, and the relationship is of such significance that it would be misleading to exclude information about it. The parties engaged in these relationships are “related parties.” With respect to related parties, the disclosures would provide information about the nature of the government’s relationship with the related party and other information to aid in understanding the relationship, including exposures to risk of loss or potential gain as a result of the relationship.

This Statement is effective for periods beginning after September 30, 2017. Earlier implementation is not permitted.

Table Of Contents

Introduction

Purpose

1. The federal government and its relationships with organizations have become increasingly complex. Notwithstanding these complexities, **general purpose federal financial reports**[1] (GPFFR) for the government-wide reporting entity should be broad enough to reflect the Congress and/or the President's accountability for those organizations. In addition, **component reporting entity** GPFFRs should allow the Congress and /or the President to hold management accountable. Although Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, addresses identifying **reporting entities** and criteria for including components in a reporting entity, questions have continued in this area indicating the need for standards.[2] Standards that can be used to identify organizations to include in the GPFFR of the government-wide reporting entity and each component reporting entity are important to meet federal financial reporting objectives.

2. This Statement guides preparers of GPFFRs in determining what organizations to report upon, whether such organizations are considered "consolidation entities" or "disclosure entities"[3] and what information should be presented. This guidance, together with existing guidance, will ensure that users of GPFFRs are provided with comprehensive financial information about federal reporting entities and their relationships so that federal financial reporting objectives[4] are met. This statement requires reporting entities to disclose certain information about disclosure entities administratively assigned to them. It does not require new **disclosures** regarding consolidation entities administratively assigned to reporting entities. Any existing required disclosures for the consolidated financial statements of the reporting entity, which include the consolidation entities, would continue to apply. While not specifying the inclusion of classification of the components of the central banking system,

[1]Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[2] Statement of Federal Financial Accounting Concepts 2 is considered Other Accounting Literature. See Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the Financial Accounting Standards Board,* for more information regarding the hierarchy.

[3] "Consolidation entities" and "disclosure entities" are terms used to distinguish between entities based on the degrees to which the entity is (1) financed by taxes or other non-exchange revenue, (2) governed by the Congress and/ or the President, (3) imposing or may impose risks and rewards to the federal government and (4) providing goods and services on a market or non-market basis. See paragraphs 38 - 55 for more information.

[4] Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting.*

this Statement does establish certain minimum disclosures regarding the central banking system.

3. This Statement also guides preparers of GPFFRs in identifying **related parties** and in determining what information to provide about related party relationships of such significance that it would be misleading to exclude information. There are disclosures required regarding the nature of the relationship and financial-related exposures to risk of loss or potential gain resulting from relationships with such related parties.

4. The guidance recognizes that an organization's legal form may not reflect the substance of the relationship between the federal government and the organization. As such, the legal form or designation of an organization does not always determine whether it should be included in the government-wide GPFFR. Even in cases where legislation indicates an organization is "not an agency or instrumentality" of the federal government, the organization should be assessed against the guidance contained in this Statement to determine whether it should be included in the reporting entity's GPFFR. Inclusion results from a need for accountability given the nature of the relationship between the federal government and the organization but inclusion does not change the legal form of the organization.

Materiality

5. 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.

Standards

Scope and Applicability

6. This Statement applies to federal reporting entities that prepare general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards*

Board (FASB). Paragraph 66 of this Statement also applies to federal reporting entities that prepare GPFFRs in conformance with GAAP as provided by paragraphs 9 through 12 of SFFAS 34.[5]

7. This Statement does not require any entity to prepare and issue GPFFRs. The purpose of this Statement is to enable federal reporting entities preparing and issuing GPFFRs to determine:

   a. whether SFFAS 34 is applicable to an organization,

   b. what organizations should be included in the GPFFR of federal reporting entities applying SFFAS 34,

   c. the manner in which information should be presented for organizations included in the GPFFR, and

   d. what disclosures, if any, are needed regarding related parties.

Definitions

8. **<u>Reporting Entity—</u>**Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term "reporting entity" may refer to either the government-wide reporting entity or a component reporting entity (see definitions below).

   Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity.[6] The criteria focus on whether:

   a. An entity's management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that the entity is included in the budget), and is held accountable for the entity's performance.

[5] SFFAS 34, footnote 4, indicates Federal Accounting Standards Advisory Board (FASAB) GAAP would be the appropriate accounting standards for federal reporting entities within the executive, legislative, and judicial branches to adopt.

[6] SFFAC 2, paragraphs 29-38, provides a discussion titled "Identifying the Reporting Entities for General Purpose Financial Reporting."

b. An entity's financial statements would provide a meaningful representation of operations and financial condition.

c. An entity's financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.

9. **Government-wide Reporting Entity—**The government-wide reporting entity's GPFFR includes all organizations for which the Congress and/or the President are accountable based on principles established in this Statement.

10. **Component Reporting Entity—"**Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.[7] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

11. **Control with risk of loss or expectation of benefit—**"Control with risk of loss or expectation of benefit" is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or to obtain financial resources or non-financial benefits.[8] See paragraphs 26 - 35 for further discussion of control.

12. **Related Parties—**Organizations are considered to be related parties in the GPFFR if the existing relationship[9] or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions.

Organizational Approach to Defining Boundaries

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different from those of all other organizations. It is an extremely complex organization responsible for the common defense and general welfare of

[7] The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

[8] For example, a non-financial benefit would be one in which the federal government benefits from a service being provided to it or on its behalf.

[9] Relationship, as used in this context, refers to material transactions or events involving both parties.

the nation. Although there are various perspectives[10] for viewing the federal government, an organizational approach was established in SFFAC 2[11] as the most appropriate perspective for understanding the composition of the federal government. SFFAC 2 established that GPFFRs should include the aggregation of organizations for which the federal government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government are such that their exclusion would cause the federal government's financial statements to be misleading or incomplete.

14. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. In some cases, disclosing financial and other information in the notes about an organization rather than consolidating financial and other information about all organizations may better meet federal financial reporting objectives.

15. This Statement first establishes the principles for identifying organizations to include in the government-wide GPFFR (see Principles for Inclusion in the Government-wide GPFFR beginning with paragraph 20) and then distinguishes between consolidation entities and disclosure entities (see Reporting on Organizations-Consolidation Entities or Disclosure Entities beginning with paragraph 38). In applying these principles and meeting the reporting requirements, "organization" refers to the organization in its entirety including all funding sources (for example, appropriations or donations). The term "organization" is used broadly and may include, among others, departments, agencies, bureaus, divisions, commissions, corporations, and components.

16. This Statement also establishes that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete (see Identifying Organizations for which Component Reporting Entities Are Accountable beginning with paragraph 56).

17. This Statement provides guidance for how to report on consolidation entities and disclosure entities (see GPFFR Consolidation and Disclosure beginning with paragraph 66).

18. This Statement establishes minimum disclosure requirements regarding the central banking system (see paragraph 79).

[10] SFFAC 2, paragraphs 13-28, discusses the organizational, budget and program perspectives of the federal government, as well as the intertwining of the perspectives.

[11] SFFAC 2, paragraphs 29-38.

19. Lastly, this Statement provides for disclosure of related party relationships of such significance that it would be misleading to exclude information about them (see Related Parties beginning with paragraph 80).

Principles for Inclusion in the Government-wide GPFFR

20. This Statement provides three principles for determining which organizations should be included[12] in the government-wide GPFFR (see paragraph 21-35). This Statement also provides an additional principle requiring inclusion of organizations if excluding them would be misleading (see paragraph 36-37). The three principles are to be applied without considering whether the relationship is temporary or permanent. However, whether the relationship is temporary or permanent would influence the likelihood that the entity exhibits the characteristics of a consolidation entity or of a disclosure entity.

21. An organization meeting any one of the three principles below is included in the government-wide GPFFR:

    a. In the Budget

    b. Majority Ownership Interest

    c. Control with Risk of Loss or Expectation of Benefit

In the Budget

22. An organization with an account or accounts listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information[13] should be included in the government-wide GPFFR unless it is a

[12] ”Included” means the information is either consolidated or disclosed.

[13] The Budget presents information in various forms for different purposes. Only the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information should be used for determining whether information about an entity should be included in the government-wide GPFFR. In the fiscal year 2015 Budget of the United States Government (the Budget), the schedule was entitled “Federal Budget by Agency and Account.”

non-federal organization receiving federal financial assistance.[14] An organization listed in the budget is a non-federal organization receiving federal financial assistance if it is:

a. a state, local or territorial government, or component thereof, or

b. a not-for-profit organization.

23. Notwithstanding the above provision regarding non-federal organizations listed in the budget, any entity meeting either of the next two principles (Majority Ownership Interest and Control with Risk of Loss or Expectation of Benefit) should be included in the government-wide GPFFR.

Majority Ownership Interest

24. The federal government (directly or through its components) may have an ownership interest[15] in an organization. An ownership interest is a legal claim on the net residual assets of an organization such as holding shares or other formal equity instruments. The holding of an ownership interest usually but not always entitles the holder to an interest in voting rights.

25. Majority ownership interest exists with over 50 percent of the voting rights or net residual assets[16] of an organization. When the federal government (directly or through its components) holds a majority ownership interest in an organization, it should be included as either a consolidation entity or a disclosure entity in the government-wide GPFFR.[17]

[14] This Statement adopts the definition of "federal financial assistance" established in the Single Audit Act Amendments of 1996. However, an organization need not be subject to the requirements of the Single Audit Act in order to qualify as a non-federal organization receiving federal financial assistance. As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-federal organizations receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance. For the purposes of these standards, federally-authorized support fees and other charges would be considered other assistance even if legislation granting authority to collect them indicates that the fees or other charges are not considered public monies of the United States.

[15] "Ownership interest" is the possession of substantially all of the benefits and risks incident to ownership. *FASAB Handbook as of June 30, 2014--Glossary*.

[16] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.

[17] Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the organization should still be assessed against the control inclusion principle and the misleading to exclude principle.

Control with Risk of Loss or Expectation of Benefit

26. An organization that is controlled by the federal government with risk of loss or expectation of benefit should be included as either a consolidation entity or disclosure entity in the government-wide GPFFR. For these purposes, control with risk of loss or expectation of benefit is defined as follows:

    Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or obtain financial resources or non-financial benefits.[18] Both the power and either the risk of loss or expectation of benefits aspects of the definition should be met to justify inclusion of an organization. Hereafter, control with risk of loss or expectation of benefit is referred to as “control.”

27. Control refers to the ability to control, whether or not that ability is actively exercised, and should be assessed at the reporting date regardless of the federal government’s ability to change it in the future. In determining whether control exists, it is necessary to determine the substance of the relationship between the federal government and the organization as it may not be completely reflected by the legal form of the relationship.

28. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an organization. Rather, it is the federal government’s authority to determine or influence the policies governing those activities that indicates control.

29. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of organizations which individually will fall on a continuum. At one end of the continuum, it is clear that an organization does not have the power to act independently and is controlled by the federal government—such as an executive department. At the other end, the organization has the power to act independently and, while the federal government may have a level of influence, it is clear that the federal government does not have control—such as a state or foreign government.

[18] For example, a non-financial benefit would arise when the federal government receives a service or a service is provided to others on its behalf.

Indicators of Control

30. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an organization. As noted above, consideration needs to be given to the nature of the relationship between the federal government and the organization and judgment applied to determine whether control exists.

31. Certain individual indicators provide persuasive evidence that control exists. Because each indicator provides strong evidence of control, meeting any one indicator would generally mean control is present. These indicators are when the federal government has the unilateral authority to:

    a. establish or amend the fundamental purpose and mission of the organization,[19] which may include authorizing the organization to exercise sovereign powers of the federal government and requiring the organization to carry out federal missions and objectives;

    b. appoint or remove a majority of the governing board members;

    c. direct the governing body regarding the establishment and subsequent revision of financial and operating policies of the organization; or

    d. dissolve the organization thereby having access to the assets and responsibility for the obligations.

32. Other indicators provide evidence that control may exist, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to or is obligated to:

    a. provide significant input into the appointment of members of the governing body of the organization or being involved in the appointment or removal of a significant number of members;

    b. direct the ongoing use of the organization's assets;

[19] Congressionally chartered not-for-profit organizations identified under United States Code (U.S.C.) Title 36, Subtitle II and III, should not be considered controlled solely because amendments to their federal charter must be enacted through legislation. Instead, consideration of control over such organizations should be based on paragraphs 31 and 32.

c. direct investment decisions including the liquidation of investments;

d. appoint or remove key executives or personnel;

e. approve the budgets or business plans for the organization;

f. require audits;

g. veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;

h. finance the deficits of, provide financial support to, or settle liabilities of the organization;

i. direct the organization to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;

j. establish, rescind, or amend the organization’s governance framework;

k. establish limits or restrictions on borrowing and investments of the organization; or

l. restrict the capacity to generate revenue of the organization, especially the sources of revenue.

Situations Where Control Does Not Exist

33. Because of the federal government’s broad powers and economic influence, control should not be inferred from either:

    a. authority to exercise regulatory powers over an organization; or

    b. economic dependency of the organization on the federal government.

34. The federal government has the power to regulate many organizations by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of organizations by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated organizations make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government’s interest in these organizations extends only to the regulatory aspects of the operations.

35. Certain organizations may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding or do business with the federal government. For example, many not-for-profit organizations rely on federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence organizations dependent on federal funding or business through purchasing power, the federal government typically does not govern their financial and operating policies.

Misleading to Exclude

36. There may be instances when an organization does not meet any one of the three inclusion principles in paragraphs 22 through 35 yet the government-wide GPFFR would be misleading or incomplete if the organization were excluded.[20]

37. Organizations should be included in the government-wide GPFFR if it would be misleading to exclude them.

Reporting on Organizations—Consolidation Entities or Disclosure Entities

38. The principles above should be used to assess what organizations to include in the GPFFR. Next, a distinction should be made between “consolidation entities” and “disclosure entities” as that distinction determines how the organizations will be reported. This distinction, which should be consistent at the government-wide and component reporting entity levels, is based on an assessment of the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis.[21] Note, however, not all characteristics are required to be met or to be met to the same degree; classification is based on the assessment as a whole.

Consolidation Entities

39. The organizations that should be consolidated in the financial statements in the GPFFR are referred to as “consolidation entities.” Generally, an organization is considered a consolidation entity if, based on an assessment[22] of the following characteristics as a whole, the organization:

[20] Although such situations would be rare, this Statement provides for situations that may arise.

[21] Goods and services are provided on a non-market basis when they are provided free of charge or at charges that bear little relationship to the cost of providing such goods or services.

[22] As discussed in paragraph 38, not all characteristics are required to be met or to be met to the same degree; classification is based on the assessment as a whole.

a. is financed through taxes and other non-exchange revenues.

b. is governed by the Congress and/or the President.

c. imposes or may impose risks and rewards to the federal government.

d. provides goods and services on a non-market basis.

40. While greater judgment will be needed to classify other organizations, organizations listed in the budget, except for non-federal organizations receiving federal assistance (see paragraph 22), generally would qualify as consolidation entities.

41. For consolidation entities, the governance structure is vertically integrated, such that the chain of command and manner of decision-making leads directly to elected officials. Vertical integration may include the establishment of organizational authorities, development and/or approval of budgets, and the appointment of organizational leaders by elected officials.

42. Entities for which the relationship with the federal government is not expected to be permanent, such as receiverships, conservatorships, and other intervention actions, would be less likely to meet these characteristics as a whole. Such entities generally would not be classified as consolidation entities.

Disclosure entities

43. The federal government has relationships with organizations afforded a greater degree of autonomy than consolidation entities. Some organizations may exercise powers that are reserved to the federal government as sovereign. Other organizations may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of (a) regulatory actions (such as organizations in **receivership or conservatorship**) or (b) other federal government intervention actions. Under such regulatory or other intervention actions, the relationship with the federal government is not expected to be permanent and such entities generally would be classified as disclosure entities when considering the characteristics taken as a whole. To avoid obscuring information about these more autonomous organizations while still providing accountability, such organizations are to be disclosed rather than consolidated in GPFFRs. Hereafter; these organizations are referred to as “disclosure entities.”

44. Disclosure entities may maintain a separate legal identity, have a governance structure that vests most decision-making authorities in a governing body to insulate the organization from political influence, and/or have relative financial independence.

45. Disclosure entities may receive limited or no funding from general tax revenues. The Congress and/or the President have less direct involvement in decision-making (governance) than in consolidation entities. Limited risks and rewards fall to the federal government. Disclosure entities may provide the same or similar goods and services that consolidation entities do, but are more likely to provide them on a market basis.[23]

46. Disclosure entities may include but are not limited to: quasi-governmental and/or financially independent entities, organizations in receiverships and conservatorships, and organizations owned or controlled through federal government intervention actions. As noted above, in some cases, the relationship with the federal government is not expected to be permanent. The following disclosure entity types, while not inclusive of all the types, are presented to assist in identifying organizations that are disclosure entities. The accompanying Appendix C—Illustrations offers non-authoritative hypothetical examples that may be useful in understanding the application of the standards.

Quasi-Governmental and/or Financially Independent Entities

47. Quasi-governmental and/or financially independent entities have relationships with the federal government that are not temporary. Such relationships may be considered long-term, or even permanent in some cases, when compared to other types of disclosure entities. Quasi-governmental and financially independent entities have different governance and financial arrangements. Their classification takes into consideration such factors as:

    a. whether the governance of the entity is through officials appointed for terms aligning with the appointing official versus longer-term appointments or other governance structures intended to insulate the entity from political influence;

    b. whether the entity is financed primarily through taxes and other non-exchange revenues versus limited or no such financing; and

    c. whether the entity provides goods and services on a non-market basis versus provides goods and services on a market basis.

48. Governance differences typically lead to greater independence. Characteristics <u>may</u> include the following:

[23] Goods and services are provided on a market basis when prices are based on the prices charged in a competitive marketplace between willing buyers and sellers.

a. Longer appointments of key executives or governing boards to allow these appointees a degree of independence from the Congress and/or the President

b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises

c. Private sector legal characteristics, such as not-for-profit status under the Internal Revenue Code

d. Exemption by statute from laws or regulations dealing with the federal budget, funds, personnel, ethics, acquisition, property, or works

e. Voluntary association with the federal government and shared purposes to implement government policies

49. Financial differences typically lead to greater fiscal autonomy. Characteristics may include the following:

a. Primarily funded from a source other than appropriations

b. Delegated financial authority to provide a service or execute a program in a manner similar to private business enterprises

c. Principally engaged in selling goods and/or services to organizations outside of the federal government

d. Intended, in the normal course of its operations, to maintain its operations and meet its liabilities from revenues received from sources outside of the federal government

50. Not all entities of a given type will meet the factors above. These factors are provided to assist in identifying entities that are quasi-governmental and/or financially independent. Examples of the types of entities that could be considered quasi-governmental and/or financially independent entities are **Federally Funded Research and Development Centers**, museums, performing arts organizations, universities, and venture capital funds. Each entity should be assessed objectively since there are likely to be differences among the entities within these example types such that some should be classified as consolidation entities and others as disclosure entities.

Receiverships and Conservatorships

51. The federal government may take control or ownership of failed financial institutions, such as banks, with no goal to maintain control or ownership. Receiverships or conservatorships are established to liquidate failing financial institutions or to guide such institutions back to safe and sound conditions.[24] Entities controlled or owned through receiverships or conservatorships are generally disclosure entities.

Federal Government Intervention Actions Resulting in Control or Ownership

52. In exceptional circumstances such as economic instability or a national security crisis, the federal government may intervene in organizations not previously meeting the inclusion principles. Interventions arise because of the federal government's broad responsibility for the well-being of the country. Some, but not all, interventions establish ownership or control such that the organization then meets the inclusion principles. Although intervention actions are not expected to be permanent, they may not be subject to a defined time limit.

53. Typically federal government intervention actions are not routine activities. Strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate organizations acquired through interventions.

54. Examples of intervention actions resulting in control or ownership include:

    a. The federal government provides financial support and, in doing so, obtains control of an established organization but expects to relinquish or cede control.

    b. The federal government acquires an ownership interest in an organization but expects to end its interest as soon as practicable.

55. These relationships with the federal government are not expected to be permanent and such entities generally would be classified as disclosure entities when considering the characteristics taken as a whole. Nonetheless, entities controlled or owned as a result of intervention actions at the fiscal year-end must be assessed to confirm the classification.

[24] For example, the Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress with the mission "to maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and, managing receiverships."

Identifying Organizations for Which Component Reporting Entities are Accountable

56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity[25] and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

57. A component reporting entity's GPFFR should include all organizations that would allow the users to hold the component reporting entity's management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities[26] and disclosure entities administratively assigned to it.

58. Administrative assignments to component reporting entities are typically made in laws and policy documents such as statutes, budget documents, regulations, or strategic plans. Administrative assignments can be identified by evaluating:[27]

    a. Scope of the Budget Process

    b. Accountability Established Within a Component Reporting Entity

    c. Misleading to Exclude and/or Misleading to Include

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[25] SFFAC 2, paragraph 38.

[26] A consolidation entity comprises all consolidation entities administratively assigned to it and should present information about disclosure entities assigned to it.

[27] Component reporting entities should develop processes to ensure they identify and assess any organizations (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. It is anticipated that central agencies will determine if there is a need for coordinated guidance to ensure government-wide consistency.

Scope of the Budget Process

59. Consolidation entities and disclosure entities subject to the budget approval and oversight process of the component reporting entity head should be included in the component reporting entity GPFFR. Each component reporting entity should include:

    a. all consolidation entities listed within its section of the *Budget of the United States Government: Analytical Perspectives--Supplemental Materials* schedule that provides budget account level information,[28] and

    b. all disclosure entities included within its congressional budget justification.[29]

Accountability Established Within a Component Reporting Entity

60. Consolidation entities and disclosure entities for which a component reporting entity has been assigned accountability responsibilities should be included in the GPFFR of that entity. Determining whether accountability was established or assigned to a component reporting entity requires the consideration of certain indicators and the application of professional judgment. Indicators[30] that accountability has been established in the component reporting entity include:

    a. Statutes or regulations establishing an organization state that it is assigned to or part of a larger federal organization.

    b. An organization is included in the component reporting entity's published organization chart.

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[28] The Budget presents information in various forms for different purposes. Only the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information should be used for determining whether information about an entity should be included in the government-wide GPFFR. In the fiscal year 2015 Budget of the United States Government (the Budget), the schedule was entitled "*Federal Budget by Agency and Account.*"

[29] A congressional budget justification is a document submitted annually to Congress to justify an organization's budget request.

[30] These indicators provide evidence that accountability was established or assigned to a component reporting entity. Meeting any one would typically mean accountability was established.

c. The component reporting entity acquires and/or monitors[31] ownership interests in organizations where there are ongoing responsibilities[32] such as:

   i. coordinating and/or conveying input on strategic plans,

   ii. providing appropriated funds to the organization and receiving requests for funding in the current and/or future years,

   iii. administering any federal grants or contracts awarded to the organization,

   iv. monitoring activities and/or reporting on outcomes, or

   v. monitoring the value of the ownership interest.

d. A controlled organization[33] was established by statute or by action of the component reporting entity to support the mission of the component reporting entity, and a continuing relationship exists. Examples of continuing relationships include those in which the component reporting entity:

   i. approves bylaws including any amendments;

   ii. is represented on the governing board (for example, as an ex-officio member);

   iii. appoints members of the governing board;

   iv. coordinates and/or conveys input on strategic plans;

   v. monitors organizational performance;

   vi. approves budgets, operating plans, or contracts with others;

   vii. establishes and executes cooperative agreements with the organization;

[31] Such responsibilities may be assigned to a program office.

[32] These responsibilities are examples of actions or activities performed by the component reporting entity that are indicative of monitoring an ownership interest in an organization, which is an indicator of accountability.

[33] Where control exists at the government-wide level based on paragraphs 26-35.

viii. administers federal grants to or contracts with the organization;

ix. testifies before Congress regarding organization performance and objectives; or

x. has significant financial transactions or balances that indicate ongoing managerial involvement.

61. If more than one component reporting entity is assigned responsibilities as described above, the following guidance applies:

a. Disclosure entities should be included in the GPFFR of each component reporting entity assigned such responsibilities.

b. Consolidation entities should be administratively assigned to only one component reporting entity.[34] The component reporting entity assigned the largest share[35] of responsibilities described in paragraph 60 generally should include the consolidation entity.

62. If a disclosure entity has not been administratively assigned to a consolidation entity, the disclosure entity should be reported by a component reporting entity (a) assigned responsibility for transferring funds to or receiving funds from the disclosure entity or (b) with which its mission most closely aligns.

Misleading to Exclude and / or Misleading to Include

63. There may be instances where an organization is not administratively assigned to the component reporting entity based on the principles in paragraphs 59-62 yet the component reporting entity GPFFR would be misleading or incomplete if the organization were excluded. If so, such organizations should be included in the component reporting entity's GPFFR.[36]

64. There may be instances where the principles in paragraphs 59-62 are met in form but not substance so that consolidation at the component reporting entity level would result in

[34] Note that the component reporting entity to which a consolidation entity is administratively assigned may also be administratively assigned to a higher-level component reporting entity.

[35] Largest share as used here is based on the most significant administrative role.

[36] Although such situations would be rare, this Statement provides for situations that may arise.

misleading presentation for the component reporting entity. While such conditions are expected to be rare, if it would be misleading to consolidate the organization in the component reporting entity GPFFR, the organization may be excluded so long as it is consolidated in another component reporting entity or directly in the government-wide reporting entity.

65. Determining whether it would be misleading to include a consolidation entity administratively assigned to a component reporting entity requires the application of professional judgment. Examples[37] of indicators that it may be misleading to include an organization are:

    a. The budget submission is combined prior to submission but is not jointly developed or executed, as indicated by:

        i. the budget request not being directly approved by component reporting entity management, or

        ii. the absence of significant involvement by component reporting entity management regarding budget execution, investments, or strategic planning.

    b. The component reporting entity provides little or no direct oversight of the organization.

    c. The organization's funding is separate from the component reporting entity's funding.

    d. The consolidated cost information would be misleading.

    e. The organization operates itself as a stand-alone organization (either since its inception or for a long history), has routinely prepared annual audited financial statements, and has submitted financial data directly to the Department of the Treasury for the government-wide GPFFR.

[37] The indicators listed in paragraph 65 a. – e. are examples and there may be other indicators not included on this list. Further, no specific number of indicators need be present to determine an organization would be misleading to include. This determination is based on the assessment as a whole after considering all facts and often requires professional judgment in making such decisions.

GPFFR Consolidation and Disclosure

Consolidation entities

66. Consolidation entities' financial statements should be consolidated for the government as a whole to facilitate an assessment of the financial position[38] of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Component reporting entities should consolidate the financial information for all consolidation entities administratively assigned to them. Consolidation[39] aggregates the individual financial amounts of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing taxpayer-supported activities, resources, and obligations.

67. Consolidation entities as defined herein are considered federal reporting entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting* Standards Board. This Statement does not establish new disclosure requirements regarding consolidation entities but acknowledges existing standards require disclosures.

68. SFFAS 34 recognizes that some federal reporting entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the FASB. SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. Consolidation entities (that is, the consolidated government-wide reporting entity or a consolidated component reporting entity) may consolidate component or sub-component reporting entity financial statements prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations.

Reporting on Disclosure entities

69. Maintaining a distinction between the finances of consolidation entities and disclosure entities will more effectively meet federal financial reporting objectives. Such a distinction

[38] The consolidated financial statements should include amounts and balances, consistent with applicable accounting standards, even if the amounts and balances arise from or are supported by different funding sources (for example, appropriations or donations).

[39] Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

allows for separate presentation of financial information for organizations where there is a difference in purpose, governance structure, and financial relationships. Disclosing financial and other information in the notes about disclosure entities rather than consolidating financial and other information about all organizations included in a GPFFR may better meet federal financial reporting objectives. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities, information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

70. For those organizations classified as disclosure entities, the preparer should exercise judgment in determining the appropriate disclosures based on the factors and principles provided herein. Information regarding disclosure entities should be disclosed in accordance with Disclosure Requirements as detailed in paragraphs 72 to 75 below after considering the factors listed in paragraph 71.

Factors in Determining Disclosures

71. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining the information that should be presented regarding disclosure entities. Beyond materiality, the following factors[40] should be considered in making judgments about the extent of appropriate disclosures:

   a. **Relevance to reporting objectives—**Significance of the disclosure entity's information to meeting the reporting objectives established in SFFAC 1, *Objectives of Federal Financial Reporting,* with regard to the reporting entity. In particular, this would include the significance of the information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.

   b. **Nature and magnitude of the potential risks/exposures or benefits associated with the relationship—**Information is needed to provide an understanding of the potential operational or financial impact, including financial-related exposures to risk of loss and potential gain, to the consolidation entity resulting from the disclosure entity's operations.

[40] The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

c. **Complexity of the relationship—**More complex relationships would involve additional detailed disclosures to ensure the relationship is understood by the readers.

d. **Extent to which the information interests, or may be expected to interest, a wide audience—**There may be a wide interest in the information due to the sensitivity of the relationship, materiality of the transactions, media attention, or other reasons. Interested parties may expect more extensive information regarding the disclosure entity or its relationship with the federal government.

e. **Extent to which there are no alternative sources of reliable information—**An objective of GPFFRs is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

Disclosure Requirements

72. In addition to the factors presented in paragraph 71 regarding the extent of disclosures, other qualitative and quantitative factors should be considered in determining whether information regarding a disclosure entity should be presented separately due to its significance or aggregated with the information regarding other disclosure entities. If information is aggregated, aggregation may be based on disclosure entity type, class, investment type, or a particular event deemed significant to the reporting entity.

73. Disclosures should be integrated so that concise, meaningful, and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure entity or entities and related balances, or by incorporating references to relevant notes elsewhere in the GPFFR but relating to the disclosure entity or entities. For example, a reference may be made to a note regarding investments in the disclosure entity.

74. For each significant disclosure entity and aggregation of disclosure entities, information should be disclosed to meet the following objectives:[41]

a. **Relationship and Organization:** The nature of the federal government's relationship with the disclosure entity or entities.

b. **Relevant Activity:** Nature and magnitude of relevant activity during the period and balances at the end of the period.

[41]The objectives are not listed in any order of preference.

c. **Future exposures:** A description of financial and non-financial risks, potential benefits and, if possible, the amount of the federal government's exposure to gains and losses from the past or future operations of the disclosure entity or entities.

75. Examples of information that may meet the above objectives and provide the necessary understanding of the disclosure entity's relationship and organization, relevant activities, and future exposures specific to the federal government are provided below. The examples are provided to assist in determining the types of information that would meet the objectives in paragraph 74. No individual example is itself a required disclosure and the examples are not required in the aggregate. The examples are listed individually and should not be considered alternatives or substitutes for one another. The list of examples below is not exhaustive and additional items of information necessary to meet the objectives should be disclosed even if not specifically identified in the list below. Disclosures that meet the objectives in paragraph 74 should be provided. In determining what information is needed to meet the objectives in paragraph 74, the factors in paragraph 71, including the complexity, nature, and magnitude of the relationship, should be considered.

   a. The name and description of the disclosure entity,[42] including information about how its mission relates to federal policy objectives, actions taken on behalf of the federal government, its organization, and any significant involvements with outside parties.

   b. The nature of the relationship between the federal government and the disclosure entity including relevant information regarding:

      i. How any control or influence over the disclosure entity is exercised;

      ii. Key terms of contractual agreements, statutes, or other legal authorities; and

      iii. The percentage of ownership interest and/or voting rights.

   c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to monitoring, operating and/or disposing of the disclosure entity and/or a statement that the intervention is not expected to be permanent.

   d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the reporting entity as a consequence

[42] For simplicity, information is described in relation to a single disclosure entity. Nonetheless, the information may be presented for an aggregation of disclosure entities.

of transactions with or interests in the disclosure entity and the basis for determining the amounts reported (or a reference to other disclosures where such information is provided).

e. A discussion of the disclosure entity's key financial indicators and changes in key financial indicators.

f. Information regarding the availability of the disclosure entity's annual financial report and how it can be obtained.

g. In the event that contractual agreements, statues, or other legal authorities obligate the reporting entity to provide financial support to the disclosure entity in the future, information regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss).

h. The nature of, and changes in, the risks and benefits associated with the control of, or other involvement with, the organization during the period.

i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the disclosure entity, including how the maximum exposure to gain or loss is determined. (If this cannot be quantified, a narrative discussion could be offered.)

j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to risk of loss or potential gain to the reporting entity, resulting from the disclosure entity's operations including important existing, currently-known demands, risks, uncertainties, events, conditions, and trends—both favorable and unfavorable.

76. Any disclosure entity's financial information presented in the reporting entity's GPFFR should be based on accrual-basis standards provided in GAAP or an other comprehensive basis of accounting developed for its specific type of entity.[43] This includes GAAP for the relevant domain (FASAB, Governmental Accounting Standards Board, or FASB).

[43] Consolidation entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

77. When information is derived from the disclosure entity's financial report, it is preferable but not mandatory that the report be for the same reporting period as the government-wide reporting entity. If a disclosure entity's reporting period differs from the government-wide reporting entity's and it is not cost-beneficial to align the reporting periods, any financial information disclosed from the disclosure entity's financial report should be for a reporting period ending within the government-wide reporting entity's reporting period.

78. Significant changes in information occurring from the end of the disclosure entity's reporting period should be reported consistent with the requirements of SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the American Institute of CPAs Statements on Auditing Standards.*

Minimum Disclosures Regarding the Central Banking System[44]

79. The following information regarding the central banking system should be disclosed[45] in the government-wide GPFFR:

    a. Description of the central banking system, including information about how its mission relates to federal policy objectives, actions taken on behalf of the federal government, its organization, and any significant involvements with outside parties.

    b. The nature of the relationship between the federal government and the central banking system including relevant information regarding governance structure with particular emphasis on matters affecting its independence and insulation from political influence.

    c. A discussion of the significance and magnitude of financial actions reported during the year by the central banking system to achieve monetary and fiscal policy objectives.

[44]Central banking system functions are currently carried out by the Federal Reserve System (FRS). The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection. The Bureau was established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law provides that the Bureau's financial statements should not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System.

[45]Depending on the circumstances, some of the listed information may be disclosed due to other requirements. The resulting disclosures should be integrated so that concise, meaningful and transparent information is provided and information is not repetitive.

d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the reporting entity as a consequence of transactions with or interests in the central banking system and the basis for determining the amounts reported (or a reference to other disclosures where such information is provided).

e. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the central banking system, including how the maximum exposure to gain or loss is determined (If this cannot be quantified, a narrative discussion could be offered.).

f. Information regarding the availability of the central banking system annual financial reports and how they can be obtained.

Related Parties

80. In addition to organizations for which the Congress and/or the President are accountable,[46] the federal government may have relationships with other parties. Only relationships of such significance that it would be misleading to exclude information about such relationships warrant disclosure.[47] Guidance is provided below but judgment will also be required to identify relationships that warrant disclosure as related parties.

81. Related parties: Organizations are considered to be related parties in the GPFFR if the existing relationship[48] or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions.

82. Significant influence (for the purpose of this Statement) is the power to participate in the policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, sometimes by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy-making process, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by a minority ownership interest, statute, or agreement.

83. Significant influence does not arise from regulatory actions or economic dependency alone. However, regulation or economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of regulation and economic dependence on a relationship.

84. Although component reporting entities of the federal government may significantly influence each other, component reporting entities are subject to the overall control of the federal government and operate together to achieve the policies of the federal government and are not considered related parties. Therefore, component reporting entities need not be disclosed as related parties by other component reporting entities.

85. Related parties *generally* would include (see paragraph 86 for organizations *generally* not included) but are not limited to:

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[46]Entities for which the Congress and/or the President are accountable are in the budget, majority owned, or controlled and would meet the inclusion principles and be reported as either a consolidation entity or disclosure entity and not be subject to related party reporting.

[47] Significance is assessed at the reporting entity and may differ among component reporting entities and the government-wide reporting entity.

[48]Relationship, as used in this context, refers to material transactions or events involving both parties.

a. **Government sponsored enterprises** not meeting the inclusion principles

b. Organizations governed by representatives from each of the governments that created the organization, including the United States, wherein the federal government has agreed to ongoing or contingent financial support to accomplish shared objectives (for example, certain multi-lateral development banks)

86. In the context of this Statement, the following generally would not be considered related parties:[49]

a. Organizations meeting the inclusion principles

b. Organizations with which the federal government transacts a significant volume of business resulting in economic dependence such as government contractors, state and local governments, and not-for-profit organizations[50]

c. Organizations owned or managed by full-time employees of the federal government or members of their immediate families

d. Full-time employees of the federal government

e. Foreign governments

f. Organizations created through treaties or trade agreements that define common goals and means for joint action where the U.S. role in governing and financing the organizations is not significant

g. Special interest groups[51]

87. Although paragraph 86 discusses the potential exclusion of certain organizations as related parties, other factors may create a need for related party disclosures for such organizations. The use of judgment will be necessary in identifying those factors consistent with the information needs described in paragraph 88.

[49] As described in paragraph 87 below, paragraphs 86a. – 86g. identify potential exclusions but judgment will be required to determine whether some pose risks that warrant disclosures.

[50] However, economic dependency, together with other factors, may give rise to significant influence and, therefore, a related party relationship.

[51] Special interest groups refers broadly to organizations whose members share common concerns and try to influence government policies. Examples include but are not limited to labor unions, trade associations, religious organizations, membership organizations, and lobbying organizations.

88. Certain information regarding significant related party relationships may enable users to better understand the financial statements of the reporting entity because:

   a. related party relationships might expose the federal government to risks or provide opportunities that would not have existed in the absence of the relationship;

   b. related party relationships can influence the way in which the federal government operates with other entities in achieving its individual objectives; and

   c. related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties.

89. For related party relationships of such significance to the reporting entity that it would be misleading to exclude information about such relationships, the following should be disclosed:

   a. Nature of the federal government's relationship with the party, including the name of the party or if aggregated, a description of the related parties. Such information also would include, as appropriate, the percentage of ownership interest.

   b. Other information that would provide an understanding of the relationship and potential financial reporting impact, including financial-related exposures to risk of loss or potential gain to the reporting entity resulting from the relationship.

Effect on Existing Concepts—Amendments to SFFAC 2, *Entity and Display*

90. This section establishes conforming amendments to the Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, as described in the following paragraphs.

91. Paragraph 2 is replaced with the following paragraph which describes the amended purpose and contents of SFFAC 2.

> The purpose of this statement is to establish concepts regarding what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there should be financial reports (hereinafter called "reporting entities"), establishes an organizational perspective for considering the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, suggests the types of information each type of report would

convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

92. Paragraphs 3 - 5 are rescinded because the preamble applicable to all concepts statements, which was adopted at the time SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* was issued, addresses the topics covered.

93. Paragraph 6a below is inserted following paragraph 6 to recognize the importance of accountability in determining organizations to be included in the reporting entity GPFFR:

    6a. SFFAC 1 also discusses accountability and users' information needs as the foundation for the objectives of federal financial reporting. Specifically, paragraphs 71-72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. …The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability." Based on the concepts established in SFFAC 1, it is clear that accountability is a fundamental goal of financial reporting to be considered in establishing the boundaries of general purpose federal financial reports.

94. Paragraph 7 is rescinded because the preamble applicable to all concepts statements addresses the topics covered.

95. Paragraph 10, first bulleted item is amended by replacing it with the following bulleted item addressing an understanding of what the reporting entity entails:

    - ensure each reporting entity includes information to support accountability by including all relevant organizations—those that are in the budget, owned by the Federal Government, or controlled by the Federal Government with risk of loss or expectation of benefit;

96. Paragraph 18, the last sentence is amended by changing 'earmarked collections' to 'dedicated collections.'

97. Paragraph 29 is amended by adding the following footnote after the first sentence:

    The Office of Management and Budget specifies the form and content of agency financial statements, pursuant to its authority under the Chief Financial Officers Act of 1990, as amended (title 31, U.S. Code, section 3515(d)) through issuance of Bulletins and Circulars.

OMB intends to base form and content on the concepts contained in this Statement. Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees.

98. Paragraph 38 is amended to exclude references to other paragraphs amended by this Statement. Paragraph 38 is replaced with the following:

    The ultimate aggregation of organizations is into the Federal Government which, in reality, is the only independent economic entity. The Federal Government encompasses all of the resources and responsibilities existing within the component reporting entities. The aggregation includes organizations for which the Federal Government is accountable as well as other organizations for which the nature and significance of their relationship with the Federal Government are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

99. Paragraphs 39 -50 are rescinded because the standards herein provide guidance on the same matters. It is not necessary or appropriate to retain the guidance in SFFAC 2.

100. The sub-heading before paragraph 51 - “Other Aspects Concerning Completeness of the Entity” - is revised to read “Other Aspects Concerning Completeness of the Component Reporting Entity.”

101. Paragraph 51 is replaced with the following:

    Identifying the organizations to include in the reporting entity is one aspect of ensuring that the users of a reporting entity’s financial reports are provided with all the information relevant to the reporting entity. However, because the only independent economic entity is the entire Federal Government, financial resources or free services are often provided from one component in the government to another component without a quid pro quo. For example, a portion of the retirement costs of Federal employees is reported by the Office of Personnel Management rather than the organizational entities employing the persons. Thus, within parameters more appropriately established in accounting standards, it is important to ensure that the reporting entity’s financial reports include amounts that are attributable to the reporting entity’s activities, even though they are recorded elsewhere. This is particularly important for costs associated with the use of human resources; personnel services are such a major part of most government activities. It is also important for the costs of services provided by other reporting entities, such as computer services provided by another unit.

102. Paragraphs 52 – 53 are rescinded because these paragraphs relate to issues covered in standards and are not necessary for understanding the notion of the reporting entity.

103. A new sub-heading “Need to Distinguish between Consolidation Entities and Disclosure Entities” is inserted at paragraph 53A.

104. Insert Paragraphs 53A – 53 E under the sub-heading: “Need to Distinguish between Consolidation Entities and Disclosure Entities” - The language provides a high level explanation of consolidation entities and disclosure entities. These are new terms introduced in this Statement critical to understanding the reporting entity concept in the federal government. More importantly, the language describes the need to distinguish them and the reason for this distinction in terms of financial statement presentation.

53A. The Federal Government is a large and complex organization. In order to fulfill public policy objectives, the Federal Government may use both consolidation entities (such as departments and agencies) and organizations that are distinct from consolidation entities to fulfill public policy objectives (such as financially independent organizations). These distinct organizations are referred to collectively as “disclosure entities.”

53B. Disclosure entities may maintain a separate legal identity, have a governance structure designed to insulate the organization from political influence, and/or be granted relative financial independence. Despite disclosure entities’ relative operational and financial independence, accountability for all organizations owned or controlled by the Federal Government rests with the Congress and/or the President. So, both consolidation entities and disclosure entities should be included in financial reports to provide accountability.

53C. It may be difficult to provide accountability, by meeting financial reporting objectives, through consolidated financial statements because they blur the distinction between consolidation entities and disclosure entities. Consolidated financial statements may obscure the fact that resources and resource allocation decisions for disclosure entities are more independent than similar decisions for consolidation entities. While consolidation entities are financed by taxes and other non-exchange revenue and governed by elected officials, disclosure entities often do not rely on taxes and other non-exchange revenue for financing or elected officials for spending authority. For example, a single-column presentation of information for all organizations likely would create a risk of incorrect inferences. Such inferences may include the amount of assets and revenues available for consolidation entities to use in general government activities, and the extent to which taxpayers stand ready to liquidate liabilities and meet expenses of disclosure entities.

53D. Maintaining a distinction between consolidation entities and disclosure entities may more effectively meet federal financial reporting objectives. Such a distinction may be maintained through discrete presentation of information regarding disclosure entities. Nonetheless, disclosures are not a substitute for consolidation entities recognizing the financial effects of transactions with disclosure entities.

53E. Consolidated financial statements for only consolidation entities will facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Consolidation aggregates the individual financial statements of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing consolidated activities supported by taxes and other non-exchange revenue, resources, and obligations. Consolidation entities are considered federal entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.* The following sections discuss display of information in consolidation entity financial reports.

105. Paragraph 78 is rescinded because it is not conceptual guidance. It identifies an expectation that material differences between the recognition and measurement requirements under the FASB and the FASAB standards will be adjusted before consolidation.

Effective Date

106. This Statement is effective for period periods beginning after September 30, 2017. Earlier implementation is not permitted.

The provision of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Introduction

A1. The federal government and its relationships with other organizations have become increasingly complex. These complex relationships make it difficult to identify federal entities for financial accountability purposes. In addition, some organizations may be viewed as "non-federal" and yet be owned or controlled by the federal government. Identifying the organizations to be included in the government-wide and component reporting entity general purpose federal financial reports (GPFFRs) is necessary to ensure the completeness of GPFFRs.

A2. GPFFRs should include the varied organizations for which the Congress and/or the President are accountable regardless of their form. Therefore, the primary reason for developing standards for the government-wide and component reporting entity GPFFRs is to ensure that users will be provided with complete financial information about the federal government. While SFFAC 2, *Entity and Display*, provides criteria for determining if an organization should be included, questions have continued in this area that resulted in the need for standards.

Project History /Task Force

A3. In 2008, the Board formed a task force to support the project. The objective of the task force was “to assist in developing the proposed standards on the boundaries of the reporting entity and specific criteria for determining whether an organization should be included.”

A4. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were presented to the Board for its consideration during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and survey work that led to the release of the *Reporting Entity* Exposure Draft. (See Appendix E for a list of task force members.)

Summary of Outreach Efforts

A5. The Exposure Draft (ED), *Reporting Entity,* was issued on April 3, 2013 with comments requested by July 3, 2013.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (for example, Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A7. This broad announcement was followed by direct mailings of the exposure draft to the following relevant congressional committees:

a. Senate Committee on Homeland Security and Governmental Affairs

b. Senate Committee on Banking, Housing, and Urban Affairs

c. Senate Committee on Rules and Administration

d. House Committee on Science, Space, and Technology

e. House Committee on Oversight and Government Reform

f. House Committee on Financial Services

A8. Additional types of relevant organizations were contacted with direct mailings such as museums and performing art organizations, organizations that apply FASB GAAP, and intelligence agency organizations.

A9. Thirty-nine responses were received from preparers, auditors, professional associations, and citizens. In addition, over ten participants provided testimony on the issues surrounding the project to the Board at a public hearing.

A10. The Board did not rely on the number 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 considered the arguments in each response, as well as the testimony provided at the public hearing, and weighed the merits of the points raised. Due to the complexity of the standard and the issues raised, it was deemed most efficient and appropriate to include the summary of the issues raised by respondents and disposition in the narrative relating to the Board's deliberation of the issue.

Organizational Approach to Defining Boundaries

Underlying Concepts

A11. The federal government is complex and therefore defining the boundary of GPFFRs may be difficult. Its constitutionally established powers and often its motivations and functions are different from other organizations. Despite these complexities, difficulties, and differences, accountability is a fundamental goal of financial reporting. As noted in SFFAC 1:

> The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the citizens, their elected representatives, federal executives, and program managers. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government.[52]

A12. SFFAC 1 discusses accountability and users' information needs as the foundation of governmental financial reporting. Specifically, paragraphs 71 and 72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. …The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability."

[52] SFFAC 1, paragraph 8.

A13. SFFAC 1 explains that the federal government has a special responsibility to report on its actions and the results of those actions. SFFAC 1 discusses the information needs of both internal and external users including the citizens, their elected representatives, federal executives, and program managers because meeting user information needs is an essential part of accountability in government.

A14. An organizationally based approach to defining boundaries supports accountability to all users but particularly to external users who may be unaware of the nature of organizational relationships. Focusing on organizations helps to identify who is accountable and for what. In addition, an organizational approach provides meaningful financial statements by aligning boundaries with defined organizations for which there would likely be users of GPFFRs.[53]

Identifying and Classifying Organizations

A15. The Board considered several alternative approaches to identifying organizations for which elected officials—the Congress and/or the President-–are accountable. This Statement provides that reporting entities should first identify what organizations[54] are to be included[55] in the reports. The three principles for including organizations in the government-wide GPFFR are: In the Budget, Majority Ownership Interest, and Control with Risk of Loss or Expectation of Benefit. This Statement also includes a provision requiring inclusion of an organization if it would be misleading to exclude it.

A16. Next, for those organizations to be included, a distinction is made between consolidation entities and disclosure entities. This distinction determines how financial information is to be presented in the GPFFR. Consolidation entity financial information is to be presented in consolidated financial statements and related notes. Disclosure entity financial information is to be disclosed in notes to the financial statements.

A17. Professional judgment is required in the application of the standards in this Statement. This Statement presents a principles-based approach to determining which organizations should be included[56] in the government-wide GPFFR because of the wide and varying relationships of the federal government. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress' and the President's accountability for organizations. This ensures that the financial reports contain

[53] See SFFAC 2, paragraphs 29-38, for a discussion of the organizational approach.

[54] "Organization" refers to the organization in its entirety including all funding sources (for example, appropriations or donations) for which the entity is accountable. It is used broadly and may include among others departments, agencies, bureaus, divisions, commissions, corporations, and components.

[55] "Included" means an organization's information is either consolidated or disclosed.

[56] Note that this Statement does not specify which organizations must prepare and issue financial statements.

all the information essential for fair presentation of the government's financial position and results of operations.

A18. One controversial matter addressed in this Statement was the inclusion of organizations where the ownership or control is intended to be temporary; such as receiverships, conservatorships, and entities owned or controlled due to intervention actions. The Board considered many options in developing the exposure draft and concluded that preparers and auditors would find it difficult to apply the notion of "temporary" absent clear guidance in the standards. In some circumstances, temporary relationships evolve into permanent relationships. Also, some federal government components are subject to sunset provisions and are also temporary. Because it was unlikely the Board could anticipate the full range of circumstances preparers and auditors may face, the Board proposed in the exposure draft that the same principles be applied to all organizations.

A19. A few respondents asked the Board to provide that relationships intended to be temporary be excluded but most agreed with the proposal. Some respondents also asked that the Board explain how the temporary status of the relationship should be considered in applying the principles. The Board revised the proposal to explicitly state that whether relationships are temporary or permanent should not be considered in determining whether an organization is included in the GPFFR. Instead, the revised standards explain that whether a relationship is temporary or permanent is likely to influence whether the entity exhibits the characteristics established for a consolidation entity or for a disclosure entity. The standards also acknowledge that receiverships, conservatorships, and intervention entities would generally be disclosure entities but also state that entities controlled or owned as a result of intervention actions at the fiscal year-end must be assessed to confirm the classification.

A20. Members discussed the potential that inclusion of such entities in GPFFRs might lead users to conclude that entities receiving temporary federal government financial assistance have become part of the federal government. The summary alerts readers that the "principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes." The Board recognizes that its responsibility is to ensure GPFFRs meet federal financial reporting objectives and that is the focus of this Statement. By avoiding subjective provisions such as "temporary" and instead establishing principles that can be applied to all relationships, this Statement supports meeting federal financial reporting objectives.

Principles for Inclusion in the Government-wide GPFFR

In the Budget

A21. Identification of an organization in the President's Budget is the clearest evidence that an organization should be included in the government-wide report. Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal organizations would be unable to conduct operations. Financial reporting objectives – budgetary integrity, operating performance, stewardship, and systems and controls – could not be met if organizations identified in the budget were not included in the financial reports. Therefore, the most efficient means to identify organizations for inclusion in the GPFFR is by their participation in the budget process as evidenced by being listed in the schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information.

Application to Legislative and Judicial Branches

A22. Although the legislative and judicial branches (and most organizations within those branches) may not be required to prepare financial statements, based on the '*In the Budget'* principle, those organizations would be reported upon in the government-wide report. FASAB GAAP would be the appropriate accounting standards for those entities within the judicial and legislative branches that prepare GAAP-based financial statements. While this Statement does not require any entity to prepare and issue a GPPFR, it does enable federal reporting entities preparing and issuing GPPFRs in conformance with GAAP as defined by SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board,* to determine what organizations should be included in GPFFRs.

Organizations Receiving Federal Financial Assistance

A23. The schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information also sometimes identifies specific recipients of federal financial assistance. SFFAC 2 (prior to the amendments set forth in this Statement) acknowledged that the schedule sometimes names an organization to receive a "subsidy" and stated "This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation." Thus, "subsidy" is the term used in SFFAC 2 (before amendments set forth in this Statement) to distinguish such "non-federal" organizations from the organizations intended to be included in the GPFFR.

A24. While the provision in SFFAC 2 was correct, this Statement establishes standards and terms used in standards should be defined. The Board considered ways to define "subsidy" but concluded it was more appropriate to rely on the existing definition of "federal financial assistance."

A25. As exposed, the proposed language attempted to ensure organizations that receive federal financial assistance[57] as defined by the Single Audit Act Amendments of 1996 but listed under an appropriation in the schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information are not automatically included in the GPFFR. Most grants are provided through programs and the recipient organizations are not necessarily listed in the budget. However, in some cases an organization is listed. The Board believes a means to confirm whether specifically identified recipient organizations are "non-federal organizations receiving federal financial assistance" is needed. When such organizations are listed in the budget, they should be assessed against the "majority ownership interest" and "control with risk of loss or expectation of benefit" principles before being excluded from the government-wide GPFFR.

A26. Although few organizations are listed in the budget as receiving subsidies, respondents questioned (1) whether such organizations had to be subject to the requirements of the Single Audit Act to be considered, (2) whether federally authorized "support fees" would meet the definition of assistance, and (3) whether listing within the budget should be an inclusion principle given this practice. Because of these questions, the wording was clarifed to provide that such non-federal organizations would be state, local, or territorial governments (or components thereof) or not-for profit organizations. In addition, the footnotes clarify that the exclusion is not limited to organizations subject to the Single Audit Act or to specific forms of financial assistance. Lastly, if an organization listed in the budget is to be excluded it is because it is neither owned nor controlled as defined in these standards.

[57]This Statement adopts the definition of "federal financial assistance" established in the Single Audit Act Amendments of 1996. However, an organization need not be subject to the requirements of the Single Audit Act in order to qualify as a non-federal organization receiving federal financial assistance. As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance. For the purposes of these standards, federally-authorized support fees and other charges would be considered other assistance even if legislation granting authority to collect them indicates that the fees or other charges are not considered public monies of the United States.

Organizations Partially in the Budget

A27. The Board deliberated the issue of certain organizations being partially in the budget (for example, some of their operations or accounts are not in the President's Budget), such as a museum receiving substantial donor support. The Board determined organizations should be included in the government-wide GPFFR based on the "in the budget" principle. The Board further decided that such organizations should be presented in the same manner as other consolidation entities or disclosure entities, as discussed later in this Statement. Therefore, the language in the principle ("in the budget") does not provide separate and distinct guidance for organizations partially funded by non-budgetary sources. This means the organization is either a consolidation entity or a disclosure entity and should be reported as one or the other, in its entirety.

A28. Certain respondents expressed concern because donated funds are for specific purposes and are not available for general government use. They believed full consolidation may be misleading. However, entities receiving donations administer and are accountable for both appropriations and donated funds. Presently, the financial statements for museums receiving donations display consolidated totals along with separate columns for federal and donor funds. This presentation provides accountability for all funds under the entity's management while alerting the reader to restrictions. Similar presentation at the government-wide level may be accomplished by presenting donated funds as dedicated collections to the extent they meet this definition. For example, such reporting would reveal that donor funds are unavailable for general use by the government.

Need for Additional Principles

A29. While the principle "in the budget" is the most efficient means to identify organizations for inclusion, there are additional principles to be considered to identify other organizations that should be included in the government-wide GPFFR. The budget principle represents a starting point in analysis but accountability goals could not be met solely through that principle. Because the budget's purposes differ from financial reporting objectives in many respects (such as the focus on the allocation of budgetary resource flows versus costs of operations), it is possible that organizations or activities might be excluded from the budget for reasons that do not justify exclusion from financial reports. For example, some organizations may be established to operate in a manner similar to businesses and are excluded from the budgetary process. Therefore, additional inclusion principles are necessary to ensure completeness in the context of the federal financial reporting objectives.

Majority Ownership Interest

A30. Ownership interests typically provide owners access to resources and exposure to risks while supporting their desired goals. Federal financial reporting objectives require that information about service efforts, costs, and accomplishments be made available. To ensure such information is included, when the federal government holds a majority ownership in an organization, the organization should be included in the GPFFR. As described in this Statement, majority ownership interest exists with over 50 percent of the voting rights or the net residual assets of an organization.

A31. The Board noted that some may question how to account for minority ownership interests (less than 50 percent). The Board agreed addressing minority interests through the project is likely to be less effective than allowing the GAAP hierarchy to fill any void. To address the potential question, the Board included within this Statement a footnote stating ownership interests 50 percent or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy.

Control with Risk of Loss or Expectation of Benefit

A32. When the federal government controls an organization with risk of loss or expectation of benefit, the organization should be included in the government-wide GPFFR to provide accountability. As detailed in this Statement, control involves the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to obtain financial resources or non-financial benefits or be obligated to provide financial support or assume financial obligations as a result of those actions. Both the power and the risk of loss or expectation of benefit aspects of the control definition should be present to justify inclusion of the organization in the GPFFR.

A33. For example, this Statement provides for situations where the risk of loss or expectation of benefit does not exist—in the instance of the federal government exercising regulatory powers over an organization. In these cases, the federal government is unable to exercise that power for its own benefit and rarely explicitly assumes risk of loss. Therefore, including such an organization in the GPFFR would misrepresent the financial position and results of operation of the government. This would not support achievement of the objectives of financial reporting.

A34. For financial reporting purposes, assessment of control is made at the reporting date and based on current legislation, rather than legislation that may or may not be enacted in the future.

A35. Determining control requires judgment, and this Statement provides indicators to assist in making determinations. The first set of indicators is “persuasive” as the federal government has the authority to control and any one of the listed items would generally mean control is present. The second set of indicators requires more judgment because the set of indicators is considered in the aggregate to assess whether the federal government has the ability to control the organization.

A36. Because the federal government does not usually seek only financial benefits, the expected benefit associated with control does not have to be a financial benefit. Instead, it may be non-financial. For example, it may be in the form of a service provided on the federal government's behalf or the ability to direct the work of the other organization to deliver goods and services.

Misleading to Exclude

A37. This Statement includes a general provision requiring inclusion of an organization if it would be misleading to exclude it. In developing the proposal, some Board members and respondents to the proposal believed this may be problematic because no criteria are offered. However, the Board ultimately agreed the general provision could accommodate unique situations that may arise in the future. This is consistent with provisions of SFFAC 2 and the Governmental Accounting Standards Board Statement 14, *The Financial Reporting Entity*.

A38. Requiring inclusion of an organization that would be misleading to exclude allows for judgment in unique situations not anticipated when the standards were developed. If it were feasible to anticipate such situations and develop criteria, then there would be no need for the misleading to exclude provision. While there are concerns regarding possible unanticipated consequences, the Board believes the provision will be of benefit during the implementation period. If adjustments are needed, agencies may seek amendments to the standards or additional guidance as appropriate. Further, the Board also may consider whether the provision is necessary after implementation.

Reporting on Organizations—Consolidation or Disclosure

A39. Differences in purposes and governance structures by organizations may require different presentation of related financial information. This Statement provides that the reporting entity should first determine which organizations are to be included in its GPFFRs. Next the reporting entity should classify each included organization as a consolidation entity or a disclosure entity. Different means of presenting relevant information are provided for consolidation entities and disclosure entities. Consolidation entities[58] should apply the

[58] Consolidated financial statements provided for "consolidation entities" will include all disclosures and required supplementary information required by existing standards. Existing standards will ensure that adequate information is provided regarding the nature and organizational structure of consolidation entities as well as the activities and future exposures.

hierarchy of GAAP established for "federal reporting entities" in Statement of Federal Financial Accounting Standards (SFFAS) 34. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities; information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

A40. The distinction between consolidation entities and disclosure entities is based on the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis. Maintaining a distinction between consolidation entities where financial and operational decisions are more directly governed by the Congress and/or the President, and disclosure entities that are more financially (or operationally) independent will provide information to users that is more understandable and relevant. In some cases, disclosure of information regarding an individual organization is more useful than consolidation of the individual organization's financial statements in the government-wide financial statements. In other instances, consolidation of individual organizations' financial statements is needed to provide fair presentation of activities financed by taxes and other non-exchange revenue, and/or relying on the taxpayers to settle liabilities.

A41. While principle-based standards do not explicitly classify specific organizations as consolidation entities or disclosure entities, the Board considered the need to illustrate how the inclusion principles and the criteria for classification as a consolidation entity or disclosure entity might be applied to certain significant individual organizations or classes of organizations. For many classes of organizations, illustrations are provided in Appendix C. With respect to certain significant organizations with particularly unique characteristics, such as the central banking system (Federal Reserve System (FRS)),[59] a majority of the Board did not believe illustrations would be appropriate because the illustrations might become de facto requirements regarding that entity's classification.

A42. The role of preparers and auditors is to assess each organization against the principles in paragraphs 22 – 55 and reach their own conclusions. In contrast, the role of standards-setters is to set accounting standards and consider the potential implications. In doing so, the Board acknowledges some members believe the Board should explicitly address

[59]The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection. The Bureau was established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law provides that the Bureau's financial statements should not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System. (The Bureau has been consolidated directly in the government-wide report to date.) For simplicity, the basis for conclusions discusses the system as a whole rather than its individual components.

inclusion and classification (as a consolidation entity or disclosure entity) of the FRS in GPFFRs because of the magnitude of its operations. While different individuals could reach different conclusions due to the unique and changing role of the central banking system, most members believe explicitly classifying the FRS, or any entity, at a point in time would be inappropriate and result in this Statement becoming outdated as circumstances change.

A43. Despite the decision not to explicitly classify the FRS, the Board considered each possible classification of the FRS. This consideration did not take into account all the facts and circumstances that would be considered by the preparer and auditor. Instead, like the illustrations in Appendix C, high-level facts were considered in sufficient detail to provide reasonable assurance to the Board that preparers and auditors would consider the appropriate matters in making decisions. The majority of the Board believes the principles are sufficient to aid preparers and auditors in assessing any organization, including the FRS, and in making decisions regarding inclusion and classification as a consolidation entity or disclosure entity.

A44. If the assessment of the FRS resulted in its classification as a consolidation entity, the government-wide consolidated financial statements and related notes would present information as if the FRS and other consolidation entities operate together as a single economic entity. Any balances and transactions among the consolidation entities would be eliminated. For example, all Treasury securities held as investments by the FRS and reported as liabilities by the Department of the Treasury would be eliminated. Significant additions to the government-wide balance sheet as a result of consolidating the FRS would be liabilities for deposits of depository institutions and Federal Reserve notes outstanding as well as assets for investments in non-federal organizations. Consolidation would also affect the reported operating results of the government; interest expense would be reduced by the amount paid by the U.S. Treasury to the FRS and revenue would be reduced by the amount paid by the FRS to the U.S. Treasury.

A45. If the assessment of the FRS resulted in its classification as a disclosure entity, disclosures regarding the FRS would aid users in understanding the FRS, its relationship with the federal government, any significant activities, and any risks posed to the federal government. Such disclosures would allow the reader to consider monetary policy and fiscal policy as distinct activities. The government-wide consolidated financial statements would present the results of fiscal policy. Consolidation of fiscal and monetary policy financial information, as described above, would result in elimination of some Treasury securities. Thus, the use of Treasury securities to conduct monetary policy and their elimination upon consolidation could obscure the Treasury securities (debt) that result from the fiscal policies of the federal government. Further, liabilities for Federal Reserve notes outstanding and deposits by depository institutions differ in character from liabilities arising from fiscal policy. In contrast, disclosures may provide an understanding of the relationship between monetary and fiscal policy and support consideration of these distinct activities.

A46. The Board recognizes the FRS performs a unique federal function—central banking—and there is only one organization of this type. The FRS is unique not only in its mission, but also in its governance, structure, activities, and the need to maintain independence. Its responsibilities are broad reaching and of great interest because of the impact of monetary policy on the country. The magnitude of its role and transactions led the Board to require certain minimum disclosures about the FRS. The minimum disclosures recognize that there is special interest in the activity of the central banking system. The minimum disclosures for the government-wide report are in addition to any other reporting requirements at the government-wide or component reporting entity levels. The minimum disclosures focus on governance, significant roles and responsibilities, the significance and magnitude of financial actions reported by the FRS to achieve monetary and fiscal policy objectives, transactions with the reporting entity, risks to the federal government, and future exposures to gains and losses. The disclosures should be integrated and, depending on the circumstances, also may be required by other provisions in this Statement or other GAAP requirements.

Consolidation entities

A47. Consolidation entities generally provide goods and services on a non-market basis. That is, prices are not established solely through market transactions where supply and demand determine price. Goods and services provided on a non-market basis may be free of charge or provided at prices that are either not economically significant or bear little relationship to the cost of the goods or services.

A48. Consolidation entities generally are financed through taxes and other non-exchange revenue as evidenced by inclusion in the budget. Significant risks and rewards fall to the federal government for consolidation entities. Inclusion in the budget is the clearest evidence an organization is relying on taxes and other non-exchange revenue and that elected officials are key decision makers.

A49. The budget is a political document serving many purposes. The 1967 *Report of the President's Commission on Budget Concepts* indicates that "the budget must serve simultaneously as an aid in decisions about both the efficient allocation of resources among competing claims and economic stabilization and growth." On the topic of coverage of the budget, the Commission recommended that "the budget should, as a general rule, be comprehensive of the full range of Federal activities." Because the budget includes "federal activities," entities listed in the budget, except those receiving federal financial assistance, generally qualify as consolidation entities.

A50. The assessment of whether an organization meets the attributes for a consolidation entity is based on the assessment of all the attributes and the degree to which each is met. As such, not all attributes are required to be met; classification is based on the assessment as a whole.

Disclosure entities

A51. Disclosure entities receive limited or no funding from general tax revenues. Disclosure entities, in contrast to consolidation entities, are often structured so there is a clear barrier or limit on taxpayer financing of the entity. Disclosure entities have relative financial independence and often provide goods and services on a market basis. This may be an effort to shield the federal government from risk.

A52. Another contrast with consolidation entities is that with disclosure entities, the Congress and/or the President have much less direct involvement in decision-making. Decision-making may rest with a governing board insulated from political influence and there may be situations where disclosure entities have a separate legal identity. In some cases, the relationship with the federal government is not expected to be permanent.

A53. It is important to recognize the continuum that exists among disclosure entities. For example, despite a greater degree of autonomy, some disclosure entities may still exercise powers that are reserved to the federal government as sovereign. Other disclosure entities may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of regulatory or intervention actions.

A54. This Statement provides categories of disclosure entities primarily as a way to help identify disclosure entities. However, this Statement does not require presentation by any specific class or category and allows flexibility in presenting information about disclosure entities. The categories of potential disclosure entities include quasi-governmental and/or financially independent entities, receiverships and conservatorships, and federal government intervention actions.

Quasi-Governmental and/or Financially Independent Entities

A55. This Statement describes quasi-governmental and/or financially independent entities as those entities where governance and/or financial differences lead to greater independence. This Statement identifies both governance and financial characteristics that would be found in this type of entity.

A56. Quasi-governmental and/or financially independent entities may include certain Federally Funded Research and Development Centers (FFRDCs), museums, performing arts organizations and universities, and venture capital funds. Because details may differ among organizations in each example type, an objective assessment may classify some individual organizations as consolidation entities rather than disclosure entities. Appendix C- Illustrations offers examples that may be useful in application.

Receiverships and Conservatorships

A57. This Statement describes receiverships and conservatorships as those failed financial institutions and banks the federal government takes control or ownership of with no goal to maintain the relationship. Absent a decision to make control permanent, such controlled or owned organizations generally would be disclosure entities.

Federal Government Intervention Actions

A58. This Statement describes federal government intervention actions as resulting from exceptional circumstances where the involvements are not expected to be permanent. SFFAC 1 acknowledges the unique nature of federal government activity and its broad responsibilities. Paragraph 50 explains “The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society…” SFFAC 1 describes the federal government’s responsibility for the general welfare of the nation in paragraph 53-54 as “a broad responsibility that involves multiple goals.”

A59. With these broad responsibilities, the federal government may decide to take certain actions or intervene in certain situations. Examples may include actions to provide stability to the financial markets, key industries, states, cities, or counties. These types of federal government interventions are considered rare.[60] Historically the federal government has been involved in few commercial enterprises on an equity basis or shared ownership basis.[61] Although the federal government may not act to maximize profits, the federal government may intervene and act in capacities to protect citizens. This may ultimately lead to taking control of organizations or acquiring some form of ownership.

A60. The federal government may also intervene by providing assistance through extending loans or debt guarantees that do not meet the inclusion principles established in this Statement . Such transactions should be accounted for in accordance with the appropriate

[60] The financial crisis that began in 2007 is considered to be the most severe since the Great Depression. (White Paper on Changes to Financial Regulations)

[61] Congressional Research Service (CRS) Report for Congress RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics.*

accounting standards per the GAAP hierarchy. This Statement does not require additional disclosures for intervention actions that do not meet the inclusion principles.

A61. The initial SFFAC 2 provided an exception for situations where the criteria leading to consolidation are met temporarily. Specifically, paragraph 45 of SFFAC 2 stated “The entity or any of the above criteria are likely to remain in existence for a time, i.e., the interest in the entity and its governmental characteristics are more than fleeting.” “Fleeting” may imply periods of one year or less to some and the Board considered how to clarify the term “fleeting.” Ultimately, the Board decided terms such as “fleeting” and “temporary” imply a time limit.

A62. However, there may be instances where an intervention is longer than one year due to the extreme factors of the national crisis. In most instances, it is difficult to establish and meet a timeline for ending an intervention. In these instances, the focus continues to be on governance and protection, rather than maximizing profits or establishing new federal government lines of business. Although the actions may be longer than one year, the interventions are “not expected to be permanent.” The Board notes that this “non-permanent” expectation would generally lead to the entities exhibiting more of the characteristics of a disclosure entity than of a consolidation entity. This is preferable to relying on “temporary” or “fleeting” which implies that a time limit could be established.

A63. A further implication the Board wishes to avoid is that organizations owned or controlled as a result of interventions are considered “federal government entities” when applying the Code of Professional Conduct established by the American Institute of CPAs.[62] This Statement recognizes that such interventions create a need for accountability but they do not make the disclosure entities arising from intervention actions “federal government entities” or federal reporting entities. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities, information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

Component Reporting Entities

A64. The Board believes there should be consistency in treatment of organizations at the government-wide and the component reporting entity levels. The reasons for including organizations at the component reporting entity level should be consistent with the reasons

[62] The American Institute of CPAs establishes ethics rules for its members through its Code of Professional Conduct. Rule 203, Accounting Principles, designates three bodies to establish accounting principles for three different domains—nongovernmental entities, state and local governmental entities, and “federal government entities.” (ET Section 203, paragraph .01)

in the government-wide entity GPFFR. Further, classification as consolidation entities or disclosure entities should be consistent in government-wide and component reporting entity GPFFRs. The Board believes a single set of principles for inclusion and classification presented from the government-wide perspective provides for the desired consistency. This is appropriate and necessary because the government-wide reporting entity is the only federal reporting entity that is an independent economic entity.

A65. Nonetheless, implementation of these principles involves the component reporting entities because the government-wide report is, for the most part, a consolidation of the reports provided by component reporting entities. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

A66. The Board believes that component reporting entities should identify consolidation entities and disclosure entities administratively assigned to the component reporting entity. Standards that are based on organization and accountability provide a more realistic view of how component reporting entities become accountable for organizations and how component entity boundaries are likely to be determined. The result will be component reporting entity GPFFRs that include all organizations for which the component reporting entity management (for example, appointed officials) are expected to be accountable.

A67. Administrative assignments to component entities are typically made in policy documents such as laws, budget documents, regulations, or strategic plans. Ultimately, component reporting entities would identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete.

A68. Administrative assignments can be identified by evaluating the following three areas:

a. Scope of the Budget Process

b. Accountability Established Within a Component Entity

c. Misleading to Exclude and/or Misleading to Include

A69. Component reporting entities should develop processes to ensure they identify and include those consolidation entities and disclosure entities that are: (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. In rare cases, a component reporting entity may find that it would be misleading to include a consolidation entity that appears to be within the scope of their budget process or to have accountability established within the component reporting entity. While most respondents agreed with the proposal, several indicated a need for implementation guidance, especially regarding the misleading to include provision. In addition, there was some confusion about how the inclusion principles applied from the government-wide perspective relate to the administrative assignments at the component reporting entity level.

A70. The Board does not intend to provide detailed administrative assignment implementation guidance at this time. Central agencies are anticipated to determine if there is a need for coordinated guidance to be developed to ensure government-wide consistency. A coordinated effort from the central agencies could promote a process to ensure the component reporting entities are performing the necessary procedures to capture the material organizations from their perspectives and also for consideration at the government-wide level. The effective date considered this and allowed sufficient time for a coordination of efforts as well as development of any needed implementation guidance.

A71. Regarding the “misleading to include provisions,” the Board made editorial changes to clarify that they expect this to occur only in rare cases where the substance of relationships between consolidation entities differs from their form. For example, the Pension Benefit Guarantee Corporation (PBGC) is legally established within the Department of Labor. Nonetheless, PBGC has always operated as a separate legal entity with a mandate to fund its operations from premiums and has provided separate audited financial statements since its inception. Some believe that it would be misleading to consolidate PBGC and Department of Labor financial statements. In contrast, the misleading to include provision would not be an appropriate justification for excluding an office such as the Office of the Inspector General from the consolidated financial statements of its associated Department.

A72. Also, some respondents questioned whether the misleading to include provision would be applicable to disclosure entities. The Board does not believe disclosure entities can be misleading to include because disclosures explain the relationship. Such explanations would prevent misleading presentations about disclosure entities.

A73. During due process, some respondents questioned the difference between the inclusion principles and administrative assignments. The inclusion principles are to be applied from a government-wide perspective; whereas administrative assignments are determined from the component reporting entity perspective. Prior to implementation of this Statement, based on initial provisions of SFFAC 2, component reporting entities apply the conclusive and indicative criteria from their perspective as individual government agencies. In some cases, no individual government agency has direct involvement in the operations of entities that nonetheless are controlled through legislation established by and/or officials appointed by elected officials. Also, some ownership documents identify the federal government as owner rather than a particular government agency. To ensure that all owned or controlled entities are included, the inclusion principles must consider the relationship of an organization and the federal government as a whole.

A74. Another key difference is that administrative assignments are assessed from the component reporting entity perspective. Therefore, component reporting entities will need to adapt to a multi-step process involving varying perspectives (inclusion principles applied from a government-wide perspective and administrative assignments from the departmental perspective). Accordingly, coordination with the central agencies during the implementation process will be important.

GPFFR Consolidation and Disclosure

A75. As noted above, decisions about the government-wide GPFFR require determining what organizations are to be included in the reports and identifying appropriate means to present relevant information about organizations. The final determination of the presentation of financial information through consolidation or disclosure is based upon the results of two assessments—first, if the organization is included and second, if those included organizations are classified as consolidation entities or disclosure entities.

A76. The Flowchart at Appendix B is a useful tool in applying the principles established. It is helpful in the assessment and applying the standards in order. It includes paragraph references to underlying principles and major decision points.

Consolidation Entities

A77. This Statement provides that consolidation entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles*, *Including the Application of Standards Issued by the Financial Accounting Standards Board*. In addition, it provides for the consolidation of the financial statements of consolidation entities so citizens may assess the financial position and the cost of operations of the federal government. Consolidation of financial information regarding the activities financed by taxes and other non-exchange revenue, resources, and obligations where governance rests with the Congress and/or the President ensures that the reporting objectives of SFFAC 1 are met.

A78. Existing guidance may also require additional information—either through disclosures or required supplementary information—regarding consolidation entities. While the term “disclosure entities” is used to refer to organizations included in GPFFRs through disclosures, readers should not infer that disclosures would not also be provided regarding consolidation entities and related activities and transactions consistent with existing standards.

Consolidation of FASB-based and FASAB-based Information

A79. While FASAB is the appropriate source of GAAP for federal entities, the Board has considered the potential ramifications when some federal entities follow GAAP for nongovernmental entities promulgated by the Financial Accounting Standards Board (hereafter “FASB GAAP”) and their information is consolidated with information based on FASAB standards. For example, federal government corporations, the U.S. Postal Service, certain component reporting entities of the U.S. Department of the Treasury and the Department of Housing and Urban Development, and some other organizations in the executive and legislative branches have historically applied FASB GAAP and continue to do so. SFFAS 34 recognizes that “general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.” SFFAS 34 also provides that a federal reporting entity preparing audited financial statements for the first time may adopt FASB standards in the rare case that the needs of its primary users would be best met through the application of FASB standards. The acceptance of these practices raises the question of whether the information prepared under FASB standards may be consolidated with information prepared under FASAB standards in consolidated reports prepared by component reporting entities and in the consolidated government-wide reporting entity.

A80. The Board has considered such issues on several occasions and provided concepts as follows:

> The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components’ financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity’s financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the other standards.[63] (SFFAC 2, *Entity and Display*, paragraph 78 (excerpt from section on “Financial Reporting For An Organizational Entity”))

[63] In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government. As such, FASAB now issues the standards, rather than issuing recommendations to OMB and GAO for issuance of the standards.

A81. The Board determined in SFFAS 34 that FASB-based statements are acceptable in certain circumstances. While there may be significant differences between FASB and FASAB standards, both standards result in accrual-basis information and disclosures that aid users in understanding the information. Converting FASB-based information to FASAB-based information for consolidated financial reports of larger organizations may not be justifiable since conversion may not aid users.

A82. Users may be confused by the presentation of different amounts for a component in its own financial report and in the consolidated financial reports of larger organizations; particularly when both amounts would be in accordance with GAAP for federal entities per SFFAS 34. In addition, conversion imposes a cost and it is not clear that the cost is justifiable based on benefits to the user. Therefore, this Statement establishes that amounts derived for component reporting entities in compliance with SFFAS 34 may be consolidated without adjustment and the aforementioned concepts from SFFAC 2 paragraph 78 are rescinded.

A83. However, if this leads to consolidation in a single line item of amounts measured differently due to differences between FASB and FASAB principles, then one would anticipate disclosures of the different accounting policies and the related amounts to aid the reader in understanding the information provided. The Board considered adopting requirements for such disclosures but believes that existing requirements and long-standing professional practices are sufficient.

A84. The Board initially proposed that activities measured in accordance with FASAB standards and amounts related to intragovernmental were required to be disclosed in the notes of component reporting entities to facilitate eliminations at the government-wide reporting level. However, after further consideration of the comments, the board determined this information may not be relevant for the component reporting entity GPFFRs and was more appropriately obtained in the Treasury closing package. Likewise, the budgetary reporting issues highlighted by respondents appeared to be a reconciliation and system issue that should be addressed in the Treasury Financial Manual instead of an accounting standard. Also during due process it was determined that certain component reporting entities reporting on a FASB basis convert their information to a FASAB basis upon consolidation. The preparers, auditors, and users believe the information is meaningful for their purposes. As this may be the case in certain instances, but not all, the Board did not want this Statement to prevent those wishing to convert from doing so if it aids the users by providing this meaningful information. Hence, while conversion may be appropriate in certain situations, it is not for all.

Disclosure Entities

A85. The Board believes consolidation of disclosure entities would not result in information meeting the basic qualitative characteristics of information in financial reports because it would not provide the most relevant, understandable, or consistent information. The Board believes consolidation of disclosure entities may obscure the boundaries of the risks and rewards intended to be assumed or gained. Further, assets that are not available for purposes other than the specific business operation of the non-consolidated organization might be commingled with federal assets, and liabilities not fully guaranteed by the federal government might be added to federal liabilities. Instead, financial balances and amounts for organizations having the characteristics of disclosure entities should be kept separate from balances and amounts for those organizations having the characteristics of consolidation entities to prevent distortions to the consolidated financial statements.

A86. The Board believes SFFAC 1 recognizes the challenges that may arise in applying traditional approaches to financial reporting. SFFAC 1 paragraph 49 states "…Federal accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment of the federal government." SFFAC 1 paragraph 105 further explains "reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives…" SFFAC 1 also provides the qualitative characteristics of information in financial reports, by identifying these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.[64]

A87. This Statement provides flexibility in identifying needed information regarding disclosure entities because the range of disclosure entities is broad and different information may need to be disclosed to meet the reporting objectives. Providing this flexibility allows the preparer to present information judged most necessary to meet reporting objectives while also providing an understanding of the potential effect of the relationship on the consolidation entity's financial statements.

Factors in Determining Disclosures

A88. Because of the flexibility needed regarding disclosures, preparers are provided a list of factors to assist in determining what disclosures to include. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining disclosure entity presentation and disclosure. Beyond materiality, the factors provided in this Statement assist in determining the nature and extent of information regarding a disclosure entity to be provided.

[64] SFFAC 1, paragraph 156.

A89. The factors are to be considered in the aggregate; no individual weight should be assigned or interpreted The assessment of the appropriate disclosures should be made after considering all the factors. During due process, several respondents disagreed with the factor " *Disclosure entity views/perspective*" that provided for consideration and judgment of about how the disclosure entity views its relationship with the federal government. Most respondents did not believe this should influence the level of disclosures and noted that often the reporting entity would not be aware of the disclosure entity views. The Board recognized that there may be situations where the disclosure entity's view regarding its relationship with the federal government should influence the type and extent of information that is disclosed. However, it may be difficult to state operationally how this would affect disclosures in given situations. Therefore, while the Board agrees this factor may be relevant, the Board nonetheless removed it from this Statement.

Disclosure Requirements

A90. The Board recognizes that although this Statement provides flexibility in meeting the disclosure objectives, a wide variety of information is listed as examples to meet the intended objectives and there are not requirements for how information must be aggregated. Qualitative and quantitative factors are considered in determining whether information regarding a disclosure entity is presented separately due to its significance or aggregated with the information regarding other disclosure entities. If information is aggregated, aggregation may be based on disclosure entity type, class, investment type, or a particular event deemed significant to the reporting entity. For example, one reporting entity may determine it appropriate to aggregate by investment types, such as equity or loan; another by disclosure entity type, such as receiverships; and yet another by class, such as museum.

A91. Further, disclosures should be integrated so that concise, meaningful and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure. Care should be taken to ensure the objectives are met, without producing unintended consequences. Preparers should keep in mind there are associated costs and potential audit implications with any information included in a GPFFR. Incorporating by reference or including other entities' summary financial statements or summary financial information generally would result in an auditor being required to gain audit assurance on that information and thereby may result in additional audit costs.

A92. The Board believes any financial information about disclosure entities in the reporting entity's GPFFR should be based on accrual basis standards specific to the type of organization while minimizing additional costs on the disclosure entity. There will be instances where information about disclosure entities is produced for reporting periods that differ from the reporting entity's reporting period. To minimize additional costs, the Board agreed that if disclosure entities have a different reporting period than the reporting entity's GPFFR, disclosure of information from a reporting period ending within the reporting entity's reporting period is acceptable. The Board performed outreach on this issue to the audit community and to the federal entity task force. Generally, the feedback supported this approach.

A93. However, due to the fact there could be a large time lag, there should be a provision for disclosing significant changes in the information as a result of events occurring after the issuance of the disclosure entities' audited financial statements and before the issuance of the reporting entity's audited financial statements for a later fiscal year-end. The Board notes this would only be necessary if the disclosure entities' summarized financial statements or summarized financial information were presented. Otherwise normal transactions would be captured throughout the year so this would be a somewhat narrowed focus.

Related Parties

A94. The Board determined it should define "related parties" and address them within this Statement for several reasons. Related party reporting is such a fundamental notion within GAAP and the auditing standards that addressing how related party concepts apply in the federal domain is important. Absent clear related party standards in the federal domain, the Board believes the private sector concepts would be applied by default and that application would be inappropriate.

A95. Because of the extent of the federal government's relationships—whether already established or implied—"related parties" concepts may result in numerous relationships requiring disclosure. Therefore, the Board requires disclosure of related party relationships of such significance to the reporting entity that it would be misleading to exclude information about them. For clarity of intent, the standards rely heavily on listing parties to be included and excluded.

A96. In addition, this Statement provides room for judgment because one cannot anticipate all types of relationships the federal government may have or might have in the future that should be reported. While the standards identify potential exclusions that generally would not be related parties (and those that may) one should consider the many complex relationships where significant influence is exerted. Judgment will be required to determine which significant influences may pose risks that warrant disclosures and these standards do not preclude the reporting of a related party if factors deem it appropriate. The related parties category is needed to provide for disclosure of those organizations that are not included under the inclusion principles but where there is an existing relationship of such significance that it would be misleading to exclude.

A97. Component reporting entities of a single controlling entity are generally subject to related party reporting requirements in other standard-setting domains but will not be considered related parties under federal standards.[65] In reaching this conclusion, the Board discussed how jointly controlled component reporting entities present information about their relationships. Presently, component reporting entities are required by OMB guidance to state in the management's discussion and analysis section that: "The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity." In addition, existing standards require recognition of inter-entity costs to ensure that cost information is not misstated as a result of relationships between component reporting entities. While members noted that readers may need additional contextual information to understand what these complex relationships imply about component reporting entity information, the decision to exclude these entities from related party reporting placed such information requirements outside the scope of this Statement.

A98. During its due process, the Board considered a request that 'related parties' language be modified to clarify that members appointed to boards as individuals and the entities they are affiliated with are not in related party relationships with the departments or agencies. The Board did not believe additional language was necessary as the broad classes of exclusions provided were sufficient. Board members noted concern with broad exclusions of board members and organizations with which they are affiliated because there may be situations where disclosures would be appropriate. Further, current practices have provided meaningful and transparent information and the Board believes this information should continue to be provided absent a change in circumstances.

A99. The Board further understood the respondent's concern that the term 'related party,' as commonly used in financial reports, may imply less than arms-length transactions. The Board believes once federal standards are issued, the term 'related parties' in the federal environment will develop its own unique meaning—that is, relationships of such significance to the reporting entity that it would be misleading to exclude information if one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions. There is a focus on exposures to risk of loss or potential gain as a result of the relationship. Additionally, the standards do not prevent an entity from referring to related parties as "affiliated institutions" or any other appropriately descriptive term. When doing so, it may be informative to explain the relationships by including information such as conflict of interest rules and other frameworks under which they operate.

A100. During due process, certain respondents asked for clarification regarding the difference between a disclosure entity and a related party. More specifically, the respondents had

[65] Therefore, intragovernmental transactions would not be considered related party transactions.

difficulty finding a distinction between the characteristics of a related party and those of a disclosure entity meeting the "misleading to exclude" inclusion principle. When considering whether the principles required clarification, the Board noted the key difference between related parties and included organizations is that related parties are not controlled or owned but are significantly influenced by or influencing the federal government. In considering whether an organization rises to “misleading to exclude” the Board believes this distinction between included organizations and related parties will be helpful. The Board did not believe there was a need to revise the standards.

A101. The Board recognizes the difficulty in applying new standards to complex relationships. However, the Board believes the standards are clear. While there is a key change in the application of principles from the government-wide perspective, central agency coordination and guidance during the implementation process will aid users in adopting this perspective.

Amendments to SFFAC 2, *Entity and Display*

A102. This Statement provides amendments to SFFAC 2, *Entity and Display*. This Statement provides a description of the change to SFFAC 2 and an explanation as to why the change is being made. Most of the conforming changes are rescissions that result from movement of criteria for determining what organizations are required to be included in the federal reporting entity’s GPFFR from a concepts statement to a standards statement.

A103. Paragraphs 54—77 and 79–-112 of SFFAC 2 address concepts outside the scope of this Statement and are not amended.

A104. In addition, no changes are made to paragraphs 11-37 of SFFAC 2 because the Board believes these paragraphs provide the conceptual underpinning for understanding the structure of the federal government and how this relates to reporting entities for general purpose federal financial reporting. Although there may be some small differences in terminology in those paragraphs, the Board did not believe they were significant enough to warrant amendments.

A105. Paragraphs 47-50 of SFFAC 2 identify certain organizations or types of organizations (the Federal Reserve System, Government Sponsored Enterprises, and Bailout Entities) that could be included in the government-wide reporting entity based on the SFFAC 2 concepts but that should not be included. This Statement establishes principles to provide users of GPFFRs with comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The principles can be applied to the organizations previously excluded and conclusions reached to include the organizations—either as consolidation entities or disclosure entities—or to continue to exclude the organizations. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

Other Unique Situations

A106. As part of the exposure draft process, the Board also asked respondents if there were other unique situations that should be addressed within this Statement. The Board received input from respondents on several example organizations that they believe should be clarified in this Statement. The Board considered the suggestions against the goal to develop principles-based standards that could be applied to all organizations. The Board believes the standards are sufficiently clear. Therefore, the Board did not revise the proposed requirements in response to these unique circumstances.

Board Approval and Dissent

A107. This Statement was approved for issuance by 8 members of the Board. One member dissented. The written ballots are available for public inspection at the FASAB's offices. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A108 through A115.

A108. Although Mr. Steinberg believes this Statement achieves the objective of providing authoritative guidance for defining the federal government reporting entity, he dissents because he believes the Statement implies, and therefore could lead readers to conclude, that the federal government considers receiverships, conservatorships, and intervention entities to be part of the federal government. He concurs that the federal government's general purpose financial report should disclose the relationships of these organizations to the reporting entity, the nature and magnitude of their relevant activities during the period and balances at the end of the period, and the reporting entity's future exposures to financial and non-financial risks and rewards resulting from these relationships, and has pointed to the numerous accounting standards already requiring those disclosures. However, he believes there are three compelling reasons for this Statement to not imply that receiverships, conservatorships, and intervention entities are part of the federal government reporting entity, as is done in paragraphs 51 through 55.

A109. Accounting literature has traditionally followed the postulate that, for an organization to be deemed part of a larger organization, the relationship has to be other than temporary—a condition that does not exist with the receiverships, conservatorships, and intervention entities. The desire to remain consistent with this postulate was pointed out by more than one respondent to the Exposure Draft. The Board, nonetheless, maintained that organizations for which the relationships are temporary, such as receiverships, conservatorships, or intervention entities, are part of the federal government reporting entity, but modified the standards to state that they would be classified generally as disclosure entities rather than consolidation entities. Mr. Steinberg believes the purpose of the postulate is to define the relationship that should exist in order that there be reporting, and not the form of the reporting itself.

A110. The <u>policy</u> of the federal government is to not engage in activities that are typically conducted by the private sector. Banking is an activity that since the nation's founding, has mostly been conducted by the private sector. Although failed and failing banks are taken into receivership, it is not because the government intends to provide banking services, but only to oversee an orderly liquidation or transfer of those banks' assets, and thereby protect the depositors. Likewise, the organizations for which the government has, from time to time, decided to provide temporary financial support, that is, intervention entities, are in sectors of the economy that the federal government recognizes are not its function: automobile manufacturing and financing, manufacture of weapons systems, commercial insurance, banking, state and local government. Listing the receiverships, conservatorships, and intervention entities as part of the federal government reporting entity, as this Statement does, can be inferred as an expansion of the federal government into areas traditionally reserved for the private sector.

A111. Some of the most strident <u>political</u> arguments in recent years are about the expanding reach of the federal government into the private sector. Issuance of an accounting standard that could be read as including in the federal government reporting entity, entities normally viewed as outside the federal government (for example, automobile manufacturers, automobile financing companies, defense manufacturers, insurance companies, privately-owned banks, state and local governments) supports the position of those who claim the federal government is slowly expanding its reach and becoming increasingly socialist. Accounting standards should neither support a political position, nor give the appearance of such.

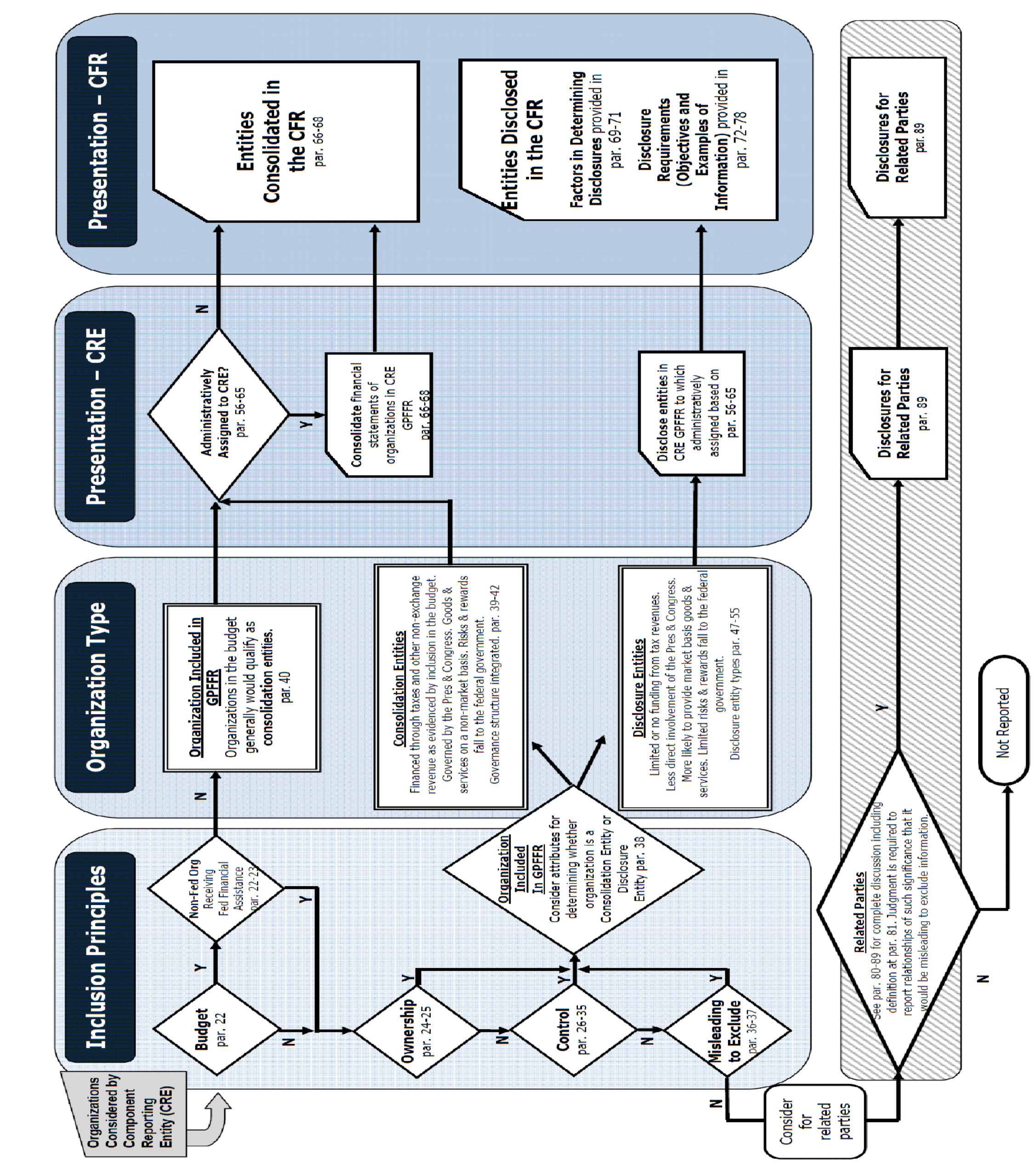
A112. Indeed, the inappropriateness of implying that receiverships, conservatorships, and intervention entities are part of the federal government reporting entity is revealed by a disavowal and apparent self-contradiction in the Statement itself. Paragraphs 51-55 identify receiverships, conservatorships, and intervention entities as one of the parts of the reporting entity that are deemed disclosure entities. Paragraph A63, on the other hand, states that the Board "wishes to avoid [the implication] that organizations owned or controlled as a result of interventions are considered 'federal government entities' when applying the Code of Professional Conduct established by the American Institute of CPAs," but then states that "this <u>does not make the disclosure entities arising from intervention actions 'federal government entities</u>.'" (underlining added)

A113. Mr. Steinberg agrees the accountability for receiverships, conservatorships, and intervention entities should be disclosed, but these types of organizations should not be listed in this Statement in such a way that they may be inferred by readers to be part of the federal government reporting entity. His beliefs are based on long-standing accounting postulates, the existing policy of the federal government, and the potential appearance that the accounting standards support a particular political agenda.

A114. Mr. Steinberg is also concerned with the manner in which this Statement provides for the reporting of museums, performing arts companies, and other entities partially funded by appropriations and partially by donations in the federal government's general purpose financial report. Specifically, these entities have often viewed the activities funded by donations as conducted by organizations that are separate from the organization performing activities funded by appropriations. They therefore provided the Department of the Treasury with information for only the activities funded by appropriations. Hence, the government-wide financial report often presented the financial position and results for only a portion of the museums, performing arts companies, and other entities funded partly by appropriations and partly by donations. The Board recognized the inappropriateness of financial statements presenting only a part of an entity and therefore agreed that the entirety of these entities should be included in the federal government reporting entity, whether through consolidation or as disclosure entities. This requirement was stated initially in two footnotes and in the Basis for Conclusions, but not in the body of the Standard. One of the footnotes was subsequently moved to the body of the Standard.

A115. Mr. Steinberg believes that while the movement of the footnote to the body of the Standard avoids the dangerous precedent of defining accounting standards in only footnotes and the Basis for Conclusions, the requirement, as stated, will enable entities to still claim that the activities funded by donations are in separate organizations that do not meet the inclusion principles of "in the budget," "majority ownership interest," or "control." Therefore these portions of the entities might be inappropriately excluded from the federal government reporting entity's general purpose financial statements.

Appendix B: Flowchart



Appendix C: Illustrations

Preamble

These illustrations demonstrate how the provisions of this Statement could be applied to organizations given simplified hypothetical circumstances. They are for illustrative purposes only and are nonauthoritative. They do not:

1. represent actual organizations,

2. provide a thorough analysis of all the facts and circumstances that are needed to reach a conclusion in practice,

3. indicate a preferred method of analyzing facts and circumstances, and

4. substitute for the application of professional judgment to actual facts and circumstances.

These illustrations follow the sequence presented in the decision flowchart in Appendix B. All tentative conclusions are based primarily on the hypothetical circumstances presented. In most illustrations, the tentative conclusions refer to consideration of other factors by management and the auditor. This reference is included to emphasize that, in practice, consideration of all relevant facts and circumstances would be needed to reach conclusions. The reader should assume that the general reference to “other factors” means that such factors, in aggregate, supported the conclusions implied by the necessarily limited assumed facts and circumstances presented in each illustration.

Application of the standards to actual organizations requires consideration of the circumstances specific to each organization and the exercise of professional judgment. Although the limited assumed facts and circumstances presented in the illustrations may be similar to situations at a particular reporting entity, they should not be used in practice as a substitute for a complete and thorough consideration of all of the relevant facts and circumstances, which may lead to a conclusion different from the tentative conclusions in these illustrations. For example, the illustrations make certain assumptions that, in practice, require judgment of the specific facts and circumstances to make appropriate determinations.

All of the illustrations discuss administrative assignments to component reporting entities where there is only one component reporting entity relationship described. In reality, more than one component reporting entity may have a relationship with the illustrative organization. In such cases, additional information would need to be considered to determine whether other administrative assignments exist.

ABC Department

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

Congress established ABC Department (ABC), a federal organization, to promote entrepreneurship and innovation as a means to address national economic and environmental challenges. Provisions that govern ABC are generally prescribed in legislation and ABC accomplishes its mission through the activities of various bureaus, grants to research institutions, and contracts with universities and not-for-profit organizations.

The executive leadership of ABC consists of a secretary, deputy secretary, and three assistant secretaries. The President nominates and the Senate confirms each of these officials. These officials serve at the pleasure of the President. ABC is subject to all laws and regulations applicable to executive branch agencies.

ABC relies on appropriated public funds to conduct its mission and is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information. The President and the Congress consider ABC's requests for resources and determine the amount that should be budgeted to provide services. Furthermore, ABC is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that ABC should be included in the government-wide GPFFR because it (1) meets the first of the three inclusion principles (being listed in the budget) and (2) is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Entity

Further, because it is listed in the budget, ABC generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts contradicting the assumption that ABC is a consolidation entity. As a consolidation entity, ABC's financial statements should be consolidated in the government-wide GPFFR.

Administrative Assignments

The assumed facts and circumstances do not indicate ABC should be consolidated with another component reporting entity. Further consideration of ABC's relationships with other consolidation entities would be needed to determine if ABC has been administratively assigned to another component reporting entity. Further consideration would also be needed to identify any consolidation entities or disclosure entities administratively assigned to ABC.

Epsilon Corporation

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

The Congress and the President established Epsilon Corporation as an independent government corporation to insure consumer funds placed in trust with certain types of institutions. Federal legislation established provisions that govern Epsilon's activities. Epsilon is governed by a seven member board of directors and each board member is appointed by the President and confirmed by the Senate. The Congress monitors Epsilon's activities by conducting hearings on Epsilon's programs and requesting Government Accountability Office (GAO) and Office of Inspector General (OIG) audits.

Epsilon is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Epsilon receives its funding based on legislation permitting it to receive and spend premiums from the institutions it insures. Legislation limits how Epsilon can invest proceeds from premiums and, to help ensure that Epsilon remains financially viable, legislation requires Epsilon to have a reserve fund. The board of directors determines the level of the reserve fund. If Epsilon encounters a shortfall, the organization may borrow a limited amount from the U.S. Department of the Treasury (Treasury), but any additional funding requirements must be obtained from premium assessments.

Epsilon is required to periodically report to the Congress and the President on matters such as:

- Program performance results
- Financial position, results of operations, and cash flows
- Adequacy of internal controls and systems

Furthermore, Epsilon is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that Epsilon Corporation should be included in the government-wide GPFFR because it meets the first inclusion principle (in the budget) and is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Entity

Further, because it is listed in the budget, Epsilon generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that Epsilon is a consolidation entity. As a consolidation entity, Epsilon's financial statements should be consolidated in the government-wide GPFFR.

Administrative Assignments

There is no information included in the assumed facts and circumstances indicating that Epsilon should be consolidated with another component reporting entity. Further consideration of Epsilon's relationships with other consolidation entities would be needed to determine if Epsilon has been administratively assigned to another component reporting entity or has had consolidation entities administratively assigned to it. Also, further consideration would be needed to identify any disclosure entities administratively assigned to Epsilon for which disclosures are needed.

Sigma Association

(Control based on Persuasive Indicator—Disclosure Entity (Financially Independent))

Assumed Facts and Circumstances

The Congress and the President established Sigma Association (Sigma) as a not-for-profit, non-taxpayer funded organization to market innovative U.S. agricultural technology worldwide and to respond to any claims of damage arising from new technology. The fundamental purpose of the corporation is specified in legislation and its mission statement is "to open new markets for U.S. agricultural technology through a cooperative marketing strategy and risk-sharing approach for market participants."

Sigma is governed by a ten-member board of directors. Five members are appointed by the President and confirmed by the Senate. Four members are elected by industry members. The

Secretary of Agriculture (or his/her designee) serves as a voting ex-officio member of the board. No more than three of the appointed members may be from the same political party. Board members serve seven-year terms and can only be removed for cause (meaning they may not be removed for policy decisions). Also, Congress monitors Sigma's activities by conducting hearings on Sigma's programs and requesting GAO audits.

Sigma is financed by fees imposed on industry members. Sigma's board of directors must establish an annual budget and legislation limits how Sigma can invest proceeds from fees. To help ensure that Sigma remains financially viable, legislation requires Sigma to have a reserve fund. The board of directors determines the level of the reserve fund after considering input from industry members. If Sigma encounters a shortfall, it may borrow a limited amount from the Treasury, but any additional funding requirements must be obtained from future fee assessments on industry members.

Tentative Conclusions

Based on the assumed facts and circumstances, and other considerations, management determined and the auditor concurred that Sigma should be included in the government-wide GPFFR because Sigma meets the third inclusion principle (control with expected benefits or risk of loss). Indicators that the federal government can control Sigma are that the Congress and/or the President (1) established its fundamental purpose and mission through legislation, and (2) appoint a majority of the members of its board of directors (its governing body). Each of these facts individually would be sufficient to indicate control such that Sigma would be included.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Sigma should be reported as a disclosure entity because it is a financially independent organization. Management and the auditor considered the assumed facts and circumstances presented below in the aggregate, weighed them against other considerations, and used professional judgment.

Evidence suggesting that it is a disclosure entity includes:

1. Tax revenue is not appropriated for ongoing operations.

2. The corporation is relatively financially independent because it is primarily funded from a source other than appropriations. Its budget and fees are not subject to Congressional or Presidential approval.

3. Having seven-year terms for directors who are not subject to removal for policy decisions indicate a higher degree of autonomy than executive branch appointees. This governance structure vests greater decision-making authority with the board while insulating it from political influence. As a result, Congressional and Presidential oversight is less direct since they are not involved in decisions such as the level of reserves needed.

4. While Sigma is permitted to borrow from the Treasury, such borrowing is limited. This means risks to the federal government are limited. Instead, Sigma is expected to maintain its operations and meet its liabilities with revenues received from sources outside of the federal government.

Evidence suggesting that Sigma may be a consolidation entity includes:

1. The President and the Senate, who appoint and confirm, respectively, members of the board of directors as well as establish organizational authorities in legislation, have a governance role.

2. Sigma provides a service that is not available from market participants. Its fees are adjusted to recover losses rather than to respond to market influences. Hence, its fees are not market-based.

Administrative Assignment

Because each disclosure entity must be reported by at least one consolidation entity, management considered whether Sigma has been administratively assigned to the Department of Agriculture. Evidence suggesting administrative assignment to the Department of Agriculture includes that the secretary serves as an ex-officio member of the board.

As a result, management determined and the auditor concurred that the Department of Agriculture should disclose information regarding Sigma in its GPFFR. If Sigma is also administratively assigned to other component reporting entities, then those component reporting entities should also consider the need to disclose information in their GPFFRs.

Scholars University

(Not Included)

Assumed Facts and Circumstances

The Congress and the President chartered Scholars University as a small, private, independent, not-for-profit educational institution and legislation describes the mission of the university. The legislation also indicates that the university is not an instrumentality of the federal government and that the federal government does not assume any liabilities of the university.

Scholars University is governed by a 29-member board of trustees. The Secretary of Education is an ex-officio member of the board and the remaining members are elected by the board for three-year terms. The board controls and directs the university's affairs such as determining the university's tuition and fee structure, adding or removing colleges within the university, and establishing new research institutions.

To support its mission, Scholars University receives most of its revenue from tuition, fees, and private contributions. The university receives appropriations to support some of its academic programs. The university is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information under a Department of Education program because an amount is appropriated for Scholars University each year. Although the appropriations discuss limitations on how the funds may be used, the university generally has discretion over how it chooses to allocate funds for its academic programs and construction activities.

Tentative Conclusions

Based on the assumed facts and circumstances and other information, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR. Although it meets the first inclusion principle (in the budget), management asserts that Scholars University is a non-federal organization receiving federal financial assistance in the form of a grant. Any non-federal organization listed in the budget should be assessed against the other two principles. So, management must determine if the other inclusion principles are met or if it would be misleading to exclude the university.

The initial analysis is summarized below:

- Ownership—The Congress and the President chartered Scholars University as a private, independent organization. There is no evidence that the federal government has an ownership interest in the university.

- Control–-Based on the assumptions presented, the persuasive indicators of control have not been met. While the federal government chartered Scholars University, the standards provide that further indicators of control must be present to conclude that the organization is controlled. The remaining persuasive indicators—appointing or removing a majority of the governing board members, establishing financial and operating policies, and dissolving the university and having access to its assets—are not met. The available facts and circumstances suggest that Scholars is not controlled. [Note, however, for brevity this illustration does not present an analysis of indicators of control that in the aggregate may reveal that Scholars is controlled. Such an analysis may be needed in practice.]

- Misleading to exclude—-Scholars University is a small not-for-profit that is listed in the Budget solely as a program within the Department of Education. Management determined and the auditors concurred that it is both quantitatively and qualitatively immaterial. Also, there were no other facts and circumstances that would suggest that Scholars University should be included in the GPFFR. As a result, it would not be misleading to exclude.

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR.

Education Research Institute (ERI)

(Control based on Persuasive Indicator—-Consolidation Entity)

Assumed Facts and Circumstances

The purpose of the Education Research Institute (ERI) is to assist state and local officials in making informed decisions regarding effective education methods. ERI was established by the Congress and the President through a public law specifying the organization's:

- status as a tax exempt not-for-profit,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The public law establishing ERI requires reauthorization of its operations every five years. If the Congress and the President do not authorize continued operation, ERI must cease operations and distribute its net assets to a successor organization designated by the federal government. If ERI is unable to satisfy its liabilities prior to dissolution, the federal government will assume its liabilities.

ERI is governed by a seven-member board of directors; five of whom are voting. Two members are specific federal officials within the Department of Education who serve part-time and do not have voting rights. The remaining five serve full-time, are appointed by the Association of Local School Boards, and serve six-year terms. One of these five members is elected by the board to serve as chairperson.

The legislation creating ERI designates funding of $1 per elementary school student per year to be made available from the general fund of the U.S. Treasury to the ERI trust fund. An annual transfer to ERI is not listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information but is included in the Department of Education's Congressional Budget Justification. The board of directors is authorized to establish an annual budget not to exceed the amounts available in the trust fund. ERI may fund up to 25% of its annual budget through donations but may not use federal funds to solicit donations.

The Department of Education approves the ERI annual budget. The department also reports information related to ERI activities in its annual performance report and Congressional Budget Justification.

ERI must provide annually an audited financial report to the Department of Education and relevant Congressional committees.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that ERI should be included in the government-wide GPFFR because the third inclusion principle (control with risk of loss or expectation of benefit) is met. A persuasive indicator of control exists because the federal government can unilaterally dissolve the organization and have access to its assets and responsibility for its liabilities.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, ERI should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that ERI is a consolidation entity.

Evidence suggesting that ERI is a consolidation entity includes:

1. It is primarily financed by taxes.

2. Federal government has assumed the risks associated with ERI's liabilities.

3. The purpose of ERI is to assist state and local officials by providing consultation services on a non-market basis.

4. ERI's annual budget is approved by the Department of Education and the Department also provides information related to ERI activities in its annual performance report and Congressional Budget Justification. These activities show that elected officials, acting with and through politically appointed officials, make decisions regarding ERI's budget.

Evidence suggesting that ERI is a disclosure entity includes:

1. A majority of the members of the board of directors is appointed by non-federal officials.

2. ERI is able to access donations to sustain some of its operations.

Administrative Assignment

The Department of Education should consider whether or not ERI is administratively assigned to it. Evidence that indicates ERI is administratively assigned includes Education's participation in ERI's budgetary process and inclusion of information regarding ERI in its own Congressional Budget Justification. Having considered the above information and other available evidence, the Department of Education determined and its auditor concurred that it should consolidate ERI's financial statements in its GPFFR.

Mediation Corporation

(Control based on Indicators in the Aggregate—Disclosure Entity)

Assumed Facts and Circumstances

Mediation Corporation (Mediation) was established as a 501(c)(3) non-member not-for-profit organization through a public law specifying the organization's:

- status and operating location,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The purpose of Mediation is to ensure that low-income individuals have access to mediation services to resolve non-criminal legal disputes. An assigned duty is to develop and maintain a network of state and local government organizations to deliver services financed by grants. Network members may raise funds to finance delivery of services through taxes, donations, and other grants without limitation.

The governing board comprises 13 members including Mediation's executive secretary. The President nominates candidates to fill the board member positions. A panel of local government officials participating in the network selects new members of the governing board from among the nominees. No more than seven members may be affiliated with the same political party. The members elect their chairperson from among the members. The President appoints the executive secretary and the Senate confirms the appointment. The executive secretary's term is fifteen years during which the President may only remove the appointee for cause.

Mediation is financed by an annual appropriation, interest earnings, and grants from any public or private grant-making organization. Grants must not finance more than 20 percent of its annual budget. The U.S. Attorney General approves the annual budget. Any liabilities incurred by Mediation must be settled from its assets and are not backed by the full faith and credit of the U.S. Government.

An annual appropriation is provided in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level for "Grants to the Mediation Corporation." The appropriation is made to the Department of Justice which transfers budget authority to Mediation. Mediation manages its cash balances similar to other not-for-profits and may retain any interest earned on unspent funds. In addition, it may apply for and receive grants from any grant making organization—public or private—subject to the 20 percent limitation.

The public law creating Mediation requires it to make annual audited financial reports publicly available. Mediation also files annual tax returns with the Internal Revenue Service. Furthermore, Mediation is considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Although Mediation meets the first inclusion principle (in the budget), it is a non-federal organization receiving federal financial assistance. To determine if Mediation should be included in the government-wide GPFFR, management considered the remaining inclusion principles—majority ownership interest and control with risk of loss or expectation of benefit.

It is unclear, based on the assumed facts and circumstances, whether Mediation is owned by the federal government and, therefore, meets the second inclusion principle. Therefore, management must consider the control indicators to determine if the third inclusion principle (control) is met. None of the persuasive indicators of control are present based on the assumed facts and circumstances so considerable professional judgment is required to determine whether—in the aggregate—the indicators provide evidence of control. The indicators suggesting federal government control over Mediation include:

1. The federal government provides significant input regarding selection of the organization's governing board members since a selection can only be made from among candidates identified by the President.

2. The President appoints a key executive—the executive secretary—and may remove him or her for cause.

3. Federal law restricts Mediation's capacity to generate revenues since only appropriations, interest earned, and grants may be used. In addition, only 20 percent of its annual needs may be met through grants.

4. The U.S. Attorney General approves the annual budget.

5. Federal law requires annual audited financial reports.

6. Federal law directs Mediation to work through a network of government agencies to provide services.

Based on the assumed facts and circumstances and other considerations, and using professional judgment, management determined and the auditor concurred that Mediation should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Mediation should be reported as a disclosure entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Mediation is a disclosure entity.

Evidence suggesting that Mediation is a consolidation entity includes:

1. It is primarily funded by taxes.

2. Elected officials determine Mediation's budget, because at least 80 percent of its funding is appropriated to Justice. In addition, an appointed federal official, the U.S. Attorney General, approves Mediation's annual budget.

Evidence suggesting that Mediation is a disclosure entity includes:

1. Members of its governing body are selected by non-federal officials, serve longer terms than political appointees, must include members from different political parties, and may only be removed for cause. These conditions insulate the governing body from political influence.

2. Mediation has some access to non-federal funding through grants and its network of service providers is free to access non-federal funding for service delivery (subject to the 20 percent limitation).

3. Federal government has not assumed risks related to Mediation's liabilities.

Administrative Assignments

The Department of Justice should consider whether or not Mediation is administratively assigned to it. Evidence that indicates it is administratively assigned includes the Department of Justice's participation in Mediation's budgetary process. After considering the above and other factors, and using professional judgment, management at the Department of Justice determined and the auditor concurred that disclosures regarding Mediation should be presented in its GPFFR.

Bicycle America, Inc. (Scenario A)

(Not Included)

Assumed Facts and Circumstances

Individual bicycle shop owners determined that a nation-wide network of shops and trails was needed to encourage greater reliance on bicycles for transportation and invested in a new corporation, Bicycle America (BA). BA's mission was to create a coast-to-coast network and ensure wide access to bicycling. Shares in the venture are held by local bicycle shops in all major cities.

BA is governed by a board of directors. The board controls and directs the organization's affairs and interests. Board members are elected by the shareholders to serve three-year terms.

Until recently, BA was able to finance its operations from user fees. A recent lawsuit led to serious financial challenges and cash was unavailable to meet pressing needs. Absent a cash inflow, BA was considering closing the trails. Due to exceptional citizen reliance on the trails for transportation and recreation, the federal government intervened and enacted legislation to provide funding.

The federal government provided a short-term loan to BA. The federal financial intervention to preserve BA was not separately identified in the Budget, but was part of a larger federal program within the Department of Transportation.

The funding legislation also established a temporary advisory committee to monitor BA's financial condition and inform Congress of potential issues that may warrant additional actions. In addition, the advisory committee will develop a plan to aid BA in returning to financial solvency and refinancing the short-term loan.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should not be included in the government-wide GPFFR. Specifically, BA is not listed in the Budget. Further, based on the available information and other considerations, management determined and the auditor concurred BA does not meet either the remaining ownership or control inclusion principle because BA continues to be owned by common shareholders and governed by the existing board of directors. The advisory committee offers advice to the Congress and does not have authority to direct BA to act. Management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustration, it would not be misleading to exclude BA.

Bicycle America, Inc. (Scenario B)

(Ownership–-Disclosure Entity (Intervention))

Assumed Facts and Circumstances

Same as above except that in addition to the actions in Scenario A above, the federal government received shares that carry 51 percent of the voting rights of BA common stock and the advisory committee will develop a plan to sell the shares.

Tentative Conclusions

Based on the changed assumptions and no information to the contrary, and using professional judgment, management determined and the auditor concurred that BA should be included in the government-wide GPFFR. When the federal government holds a majority ownership interest, albeit temporary, the owned organization should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Entity

The available facts and circumstances indicate that the federal government's involvement with BA is an intervention. Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should be reported as a disclosure entity because (1) separate legal identity is maintained, and (2) limited funding from general tax revenues is provided. The initial determination would need to be evaluated periodically to determine if the classification remains appropriate.

Administrative Assignments

Department of Transportation was assigned responsibility for transferring funds to BA which indicates an administrative assignment. As a result, management determined and their auditor concurred that the department should disclose information regarding BA in its GPFFR. If BA is also administratively assigned to other component reporting entities, then those component reporting entities should also disclose information in their GPFFRs.

Chatham Laboratory

(Control based on Persuasive Indicator—Consolidation Entity (FFRDC))

Assumed Facts and Circumstances

Federal Department of ABC (ABC) organized Chatham Laboratory as a federally funded research and development center (FFRDC) to conduct specialized engineering research that supports ABC's mission related to infrastructure and leads to improved services. As specified in the agreement, ABC provides the physical capital and ongoing funding for the FFRDC and sets research goals for Chatham.

ABC selects a contractor to operate Chatham and conduct research consistent with the established goals. ABC is not involved in the day-to-day operations of Chatham. ABC routinely evaluates Chatham's performance and maintains a research office to review strategic plans, consider progress, and serve as a liaison to other federal institutions. ABC reports on Chatham's efforts in its own performance reports.

Chatham operations are funded entirely through appropriations provided to ABC. ABC identifies Chatham in its Congressional Budget Justification but Chatham is not specifically identified in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Instead, amounts for Chatham are included in a larger research program which makes payments to the contractor consistent with the terms of the contract. Chatham's contract operator must submit financial and performance reports to ABC periodically. All Chatham assets belong to the federal government and the results of Chatham research are the property of the federal government. In addition, ABC would be responsible for liabilities arising from use of the facilities to conduct research such as environmental cleanup liabilities. ABC is also responsible for employee benefits in the event Chatham operations are terminated.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Chatham should be included in the government-wide GPFFR. While contracting for the operation of Chatham, officials at ABC also act as the governing body by establishing the purpose and mission of Chatham. Further, ABC continues in this role through its involvement in Chatham's strategic planning and monitoring of performance. Establishing the purpose and mission of an organization is a persuasive indicator that control exists.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Chatham should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Chatham is a consolidation entity.

Evidence suggesting that Chatham is a consolidation entity includes:

1. It is primarily financed by taxes.

2. The federal government has assumed the risks associated with Chatham's liabilities.

3. Chatham's annual budget is developed by ABC officials and information related to Chatham activities is provided in ABC's performance report and Congressional Budget Justification. This indicates that decision-making regarding the budget is exercised by elected officials through politically appointed officials and the budget process.

Evidence suggesting that Chatham is a disclosure entity includes:

1. Day-to-day operating decisions are made by a contractor.

After considering the above analysis and other factors, management determined and the auditor concurred that Chatham is a consolidation entity.

Administrative Assignment

ABC should consider whether or not Chatham is administratively assigned to it. In the example, evidence suggesting Chatham is administratively assigned includes ABC's role in Chatham's strategic planning, budgeting, and administration. Having considered the assumed facts and circumstances and other available evidence, the Department of ABC determined and its auditor concurred that it should consolidate Chatham's financial statements in its GPFFR.

Gotham Laboratory

(Not included–-Economic Dependency Insufficient to Show Control)

Assumed Facts and Circumstances

The Department of XYZ (XYZ), a department within the executive branch of the federal government, contracted with Gotham Laboratory (Gotham) to conduct specialized engineering research that fulfills a federal mission related to infrastructure and leads to improved services of XYZ. As specified in the agreement, XYZ provides funding to Gotham and Gotham's management team plans, manages, and executes the assigned research program.

XYZ serves on a panel providing input on the appointment of the board of directors for Gotham. However, the board of directors elects new members and the board manages Gotham's research. Gotham also may engage in any outside research activities approved by its board of directors.

Gotham performs services for various federal and non-federal organizations but receives 90 percent of its funding from XYZ. XYZ receives appropriated funds to support the Gotham research program. The remaining 10 percent of Gotham funding is derived from contracts with other federal agencies and private industry as well as donations. Gotham's budget is not reviewed or approved by any federal officials. Gotham is subject to the usual federal contract oversight and reporting requirements.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Gotham should not be included in the government-wide GPFFR. Gotham is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Further, based on the assumed facts and circumstances and other considerations, Gotham does not meet the inclusion principles of either majority ownership or control with risk of loss or expectation of benefit. Although Gotham appears to be economically dependent on the federal government, it ultimately retains discretion as to whether to accept funding or do business with the federal government. Despite the influence resulting from this dependency, the federal government does not govern Gotham's financial and operating policies. Further, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustration, it would not be misleading to exclude Gotham.

Andromeda Prime Power Systems

(Related Party—GSE)

Assumed Facts and Circumstances

The federal government created Andromeda Prime Power Systems (APPS) as a government sponsored enterprise (GSE) to facilitate commercial space travel. APPS controls interplanetary travel among a network of commercial space stations and is subject to federal regulations regarding safety and technology transfers to other nations.

APPS is governed by a nine-member board of directors elected by common stock shareholders. Board members serve three-year terms.

APPS issued common stock and received a federal government grant to finance its initial capital and startup costs. The APPS is under no obligation to return the grant funds but is expected to promote U.S. competitive interests in the emerging space travel industry.

During the reporting period, APPS' board approved a strategic plan to expand its systems to accommodate increased commercial demands and APPS issued bonds to finance the initiative. The interest rate required by lenders indicates that the market assumes the federal government has implicitly guaranteed the payment of principal and interest. In its regulatory capacity, the federal government required APPS to establish a capital reserve and created a five-member APPS Advisory Board to monitor and advise Congress on APPS' fiscal operations.

APPS derives its revenues from fees charged to commercial organizations and receives no ongoing federal support through the Budget.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that APPS should not be reported in the government-wide GPFFR as a consolidation entity or disclosure entity. APPS is not listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information and the federal government does not have a majority ownership interest in the company.

Further, management conducted a thorough assessment of control indicators and determined the federal government does not exercise control of APPS. Regulation of APPS does not, by itself, establish control.

However, based on the assumptions and other considerations, management determined and the auditor concurred that APPS should be disclosed as a related party. Related parties generally include GSEs not meeting the inclusion principles, especially those organizations for which the relationship is of such significance that it would be misleading to exclude information about it.

U.S. Museum (Scenario A)

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was organized to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship.

The Museum is an independent establishment of the federal government and is governed by a board of trustees, known as the Museum Council. The Council has 13 voting members and 2 nonvoting members. Of the voting members, 11 are appointed by the President and serve 10-year terms (appointments are staggered) and the other 2 are appointed from among members of Congress to serve during their term. The non-voting members are selected by the Council.

The Museum receives an annual appropriation as well as private donations. Annual appropriations account for approximately 90 percent of operations and activities, with the remaining 10 percent coming from donor activities and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. All donations are considered to be available for use unless specifically restricted by the donor or by time. Furthermore, the Museum is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that the Museum should be included in the government-wide GPFFR because the Museum meets the first inclusion principle (in the budget). Further, the President and the

Congress appoint the Museum Council which indicates the federal government controls the Museum which meets the third inclusion principle (control with risk of loss or expectation of benefit).

Classification as a Consolidation Entity or Disclosure Entity

Because it is listed in the budget, the Museum generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that the Museum is a consolidation entity. As a consolidation entity, its financial statements should be consolidated in the government-wide GPFFR. The financial statements included should be for the entire organization and thus include the sources and uses for both the appropriations and the donated funds.

Administrative Assignment

Based on a review by management, no other component reporting entity has been assigned administrative responsibilities for the Museum. Therefore, the Museum is consolidated only directly into the government-wide GPFFR.

U.S. Museum (Scenario B)

(Control based on Persuasive Indicator—Disclosure Entity (Financially Independent))

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was originally organized by volunteers to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship. The Museum is intended to be a self supporting operation. Shortly after its founding, it entered into a cooperative relationship with the Department of Federal Museums, a department within the executive branch.

The Museum is incorporated as a not-for-profit organization governed by the Museum Council. The Council has 15 voting members referred to as trustees. The presidentially-appointed head of the Department of Federal Museums serves as the Council chairperson. Of the remaining voting trustees, nine are appointed by the President and five are selected and approved by the Council. Except for the chairperson, all trustees serve ten-year terms which are staggered. The Council selects a Board of Directors for the Museum and appoints the Chief Executive Officer.

The Museum is a public-private partnership which receives an annual appropriation as well as private donations, rental income, and sales revenue. No fees are charged for educational events or museum tours. Rental income from the Museum facilities is derived from rates competitive with other venues for similar events. Rental of the facilities is intended to support museum activities such that the museum can eventually be self supporting. Presently, annual appropriations account for approximately 15 percent of operations and activities, with the remaining 85 percent coming from donor activities, rental income, and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. The funding received from donations is restricted to use by the Museum and the trustees approve the annual budget including rental income and fundraising goals.

The Museum's employees are not federal employees. The Museum is required to fully fund any deferred compensation programs and to advise its employees that the federal government has not guaranteed their deferred compensation.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred the Museum should be included in the government-wide GPFFR because it meets the third inclusion principle (control with risk of loss or expectation of benefit). Although the Museum also meets the first inclusion principle (in the budget), it is a non-federal organization receiving federal financial assistance. An assessment of the remaining inclusion principles shows that the Museum meets the third inclusion principle (control with risk of loss or expectation of benefit) because it is controlled by the federal government since a majority of the trustees are appointed by the President; a persuasive indicator of control.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, the Museum should be reported as a disclosure entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that the Museum is a disclosure entity.

Evidence suggesting that U. S. Museum is a consolidation entity includes:

1. Appointments to the Council are made by elected officials.

2. Museum services, educational events and tours, are provided on a non-market basis to the general public.

Evidence suggesting that U.S. Museum is a disclosure entity includes:

1. The Museum is a separate legal organization – a not-for-profit – and terms for a majority of Council members are ten-years. This insulates the organization from political influence. Further, day-to-day operations are governed by a board of directors whose members are not directly appointed by elected officials.

2. The Museum is intended to receive limited financing from taxes and market rates are charged for facility rentals.

3. The Museum is required to make explicit that any liability for deferred compensation of its employees is not guaranteed by the federal government. This indicates that limited risks are imposed on the federal government.

Disclosure entities should be presented by the component reporting entity to which they are administratively assigned and, if material, by the government-wide entity.

Administrative Assignment

Management determined and the auditor concurred the Department of Federal Museums should present the Museum as a disclosure entity in its GPFFR because the department is assigned administrative responsibility for the Museum based on appointment of its head to serve as chairperson of the Council.

Firefighters' Housing Limited Partnership

(Owned and Controlled—Consolidation Entity)

Assumed Facts and Circumstances

Agency 123 has been authorized to establish pre-positioned housing and equipment storage facilities on federal land to ensure immediate and efficient deployment of firefighting resources in response to wildfires in remote areas. The enabling legislation allows Agency 123 to enter into a wide range of financial agreements with private-sector participants to provide housing and equipment storage for the firefighters.

The agency and a private developer formed a limited partnership—Firefighters' Housing Limited Partnership (FHLP)—to develop, operate, maintain, and own all housing and storage units and facilities within a designated area for 25 years. Agency 123 leased land to FHLP under a 25-year ground lease. At the end of the 25-year ground lease, the agency has the option to renew the partnership for another 25 years. If it does not renew, all structures and land revert back to

Agency 123 in accordance with the agency's residual ownership interest. During the 25-year ground lease, Agency 123 will provide an annual payment to FHLP from its appropriated funds for management services, use of the housing by Agency 123 employees during the fire season, and equipment storage year-round.

The private sector partner is guaranteed a minimum payment from FHLP and has no ownership interest in FHLP properties. The private sector partner also is entitled to a share of profits from non-fire season vacation rentals of the housing so long as the facilities meet established condition requirements. Profits not distributed to the private sector partner are retained by FHLP and can be used for capital improvements including development of new housing in adjacent parks under similar terms.

As part of the partnership agreement, Agency 123 has significant authority to determine the policies governing FHLP's activities and to affect day-to-day decisions such as design and construction. Any debt incurred by FHLP must be authorized by the agency. Furthermore, capital and operating budgets require agency approval and financial transactions are monitored on a monthly basis by the agency's contract administration office. The partnership is required to produce audited financial statements annually.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that FHLP should be included in the government-wide GPFFR. A substantial ownership interest is present via the agency's continuing ownership interest. In addition, several control indicators are met as summarized in the following analysis of available information:

1. Agency 123 may be able to direct the partnership regarding the establishment and subsequent revision of financial and operating policies through its review and approval of operating budgets, designs, and condition of the facilities. If so, this would be a persuasive indicator of control. Management should weigh the impact of its role in directing the FHLP's financial and operating policies and consider how much discretion falls to the private sector partner.

2. Other indicators in the aggregate may indicate control. Agency 123 has significant authority to:

    a. direct the ongoing use of assets,

    b. approve the budgets and business plans for FHLP,

    c. require audits, and

d. limit borrowing and investment by FHLP.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, FHLP should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that FHLP is a consolidation entity.

Evidence suggesting that FHLP is a consolidation entity includes the following:

1. FHLP provides housing to firefighters as its primary function on a non-market basis.
2. It is financed by tax revenues supplemented by any retained profits from non-fire season rentals.
3. Decisions are made by organizational leaders at Agency 123 who are appointed by the President and confirmed by the Senate.
4. Funds transferred to FHLP will be approved through the usual budgetary process so that FHLP funding will be included in the budget approved by the Congress and the President.

Evidence suggesting that FHLP is a disclosure entity includes the following:

1. FHLP has a legal identity separate from Agency 123.
2. FHLP is authorized to provide vacation housing services to customers on a market basis and use the proceeds to first compensate the private sector partner and then reduce the cost of firefighter housing borne by the taxpayer.

As a consolidation entity, FHLP's financial statements should be consolidated by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred that Agency 123 should consolidate FHLP's financial statements because it is assigned administrative responsibility for FHLP based on its inclusion of FHLP funding in its budget request and its coordination and monitoring of FHLP's plans and performance.

The Blue Mountain Observatory

(Control based on Indicators in the Aggregate—Disclosure Entity (FFRDC))

Assumed Facts and Circumstances

Agency XYZ created an FFRDC, the Blue Mountain Observatory (BMO), to provide facilities and leadership needed to conduct scientific research in a wide range of fields, including the study of black holes. Agency XYZ is BMO's primary sponsor. University Cooperative (UC) is a not-for-profit membership corporation created by 50 universities conducting research that would benefit from use of BMO facilities. UC was created to seek the role of managing, operating, and maintaining BMO under a cooperative agreement with Agency XYZ. UC subsequently entered into a cooperative agreement with Agency XYZ.

UC is governed by a board of trustees appointed to represent each of the 50 member universities. UC trustees appoint an individual to serve as president of BMO. The trustees also oversee BMO operations including providing input on strategic plans, approving the annual program plan before its submission to Agency XYZ for approval, responding to Agency XYZ input, and monitoring financial activities including establishing investment policies. UC employs staff to perform all BMO activities and these individuals are referred to as ‘BMO employees.’ Member universities fund any non-BMO activities of UC.

The cooperative agreement between UC and Agency XYZ ensures close coordination between Agency XYZ and BMO employees. The agreement contains requirements necessary for Agency XYZ’s oversight of both BMO’s programs and UC’s management activities, including the following provisions:

1. Provide input to a strategic plan developed by BMO employees in collaboration with UC trustees. The strategic plan sets the overall direction and priorities for BMO.

2. Agency XYZ must approve the annual program plan and budget for use of resources.

3. UC must provide to Agency XYZ an annual scientific report and audited financial statements.

4. Agency XYZ participates in developing a five-year strategic plan.

5. BMO and Agency XYZ must meet annually to review progress and ensure that scientific and facility priorities remain consistent with those of Agency XYZ.

UC works cooperatively with Agency XYZ to ensure the effective implementation of the strategic mission of BMO to the benefit of the research community. Mid-way through the current cooperative agreement, Agency XYZ will conduct comprehensive reviews of science, facilities, and management to inform future decisions regarding recompetition of the cooperative agreement for the facility. UC is under no obligation to continue in its role in managing, operating, and maintaining BMO.

In the most recent fiscal year, BMO received $100 million in funding from Agency XYZ through its cooperative agreement with UC. Agency XYZ proposed the $100 million in funding in its Congressional Budget Justification and described how the funds would be used to support the research programs at BMO. In administering the funds provided by Agency XYZ for BMO programs, UC may:

1. expend funds to meet ongoing operational needs,
2. make annual cash contributions to employee benefits programs (accrued leave and pension plans),
3. make annual payments due under long-term leases, and
4. construct or purchase new assets so long as all resulting property is titled to BMO.

In the event the cooperative agreement with UC is terminated, Agency XYZ would assume management responsibility for the facility. Further, Agency XYZ would seek appropriations for termination expenses such as post-retirement benefit liabilities for BMO employees. However, Agency XYZ would be obligated to pay termination benefits only if funds were appropriated for that purpose.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BMO should be included in the government-wide GPFFR. BMO is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information so other inclusion principles must be considered. BMO facilities are owned by the federal government and new assets are titled to the federal government. With respect to the control inclusion principle, Agency XYZ establishes the fundamental purpose and mission of BMO through its participation in strategic planning and the overall effort to ensure BMO goals are consistent with Agency XYZ research goals. This effort includes annual actions to approve BMO's annual program plan and operating budget. These actions are persuasive indicators of control.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, BMO should be reported as a disclosure entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that BMO is a disclosure entity.

Evidence suggesting that BMO is a consolidation entity includes the following:

1. BMO provides, as its primary function, research facilities and leadership to university members of UC on a non-market basis. It is financed by taxpayer funds supplemented by non-government donors.

2. Key operational decisions are made by organizational leaders at Agency XYZ who are appointed by the President and confirmed by the Senate.

3. Funds transferred to BMO will be approved through the usual budgetary process so that use of tax revenues to support BMO is ultimately decided by the Congress and the President.

Evidence suggesting that BMO is a disclosure entity includes the following:

1. BMO has a legal identity separate from Agency XYZ.

2. The governance structure ensures that universities have substantial input regarding BMO’s strategic plans and annual program plan. The significant involvement of non-governmental organizations lessens political influence.

3. BMO’s liabilities are not obligations of the U.S. government.

4. BMO is authorized to accept donations from non-government organizations.

As a disclosure entity, BMO should be presented by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred that Agency XYZ should disclose information about BMO because it is assigned administrative responsibility for BMO based on its inclusion of BMO funding in its budget request and its coordination and monitoring of BMO’s plans and performance.

Table 1: Summary Application of Standard

IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?						CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
NAME	**IN THE BUDGET**	**OWNED**	**CONTROL**	**MISLEADING TO EXCLUDE**	**IS THE ORGANIZATION INCLUDED?**	**A CONSOLIDATION ENTITY (CONSOLIDATED)**	**A DISCLOSURE ENTITY (DISCLOSED)**
ABC Department	Yes				Yes	Organizations listed in the budget generally would qualify as consolidation entities.	
Epsilon Corporation	Yes				Yes	Organizations listed in the budget generally would qualify as consolidation entities.	
Sigma Association	No	No	Yes. A majority of the governing board members is appointed by the President and confirmed by the Senate and they established its fundamental purpose and mission through legislation.		Yes		Financially independent organization
Scholars University	Yes but as a non-federal organization receiving federal financial assistance.	No	No. Scholars' board of trustees elects its respective board members. Scholars' board of trustees primarily directs the university's affairs and the university seeks sources of revenue to operate virtually in a self-sustaining manner.	Management and auditor agreement based on facts and circumstances it was not misleading to exclude.	No		
Education Research Institute	No	No	Yes, the federal government can unilaterally dissolve ERI and have access to its assets and responsibility for its liabilities.		Yes	The ERI Trust Fund is primarily funded through taxes, elected officials establish ERI's budget, services are provided on a non-market basis, and federal government assume risk.	

IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?						CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
NAME	**IN THE BUDGET**	**OWNED**	**CONTROL**	**MISLEADING TO EXCLUDE**	**IS THE ORGANIZATION INCLUDED?**	**A CONSOLIDATION ENTITY (CONSOLIDATED)**	**A DISCLOSURE ENTITY (DISCLOSED)**
Mediation Corporation	Yes but as a non-federal organization receiving federal financial assistance. Therefore, must assess against other principles.	No	Yes. Considering the control indicators in the aggregate, the federal government controls Mediation. It provides significant input on the selection of governing board members, appoints a key executive, limits Mediation's capacity to generate revenue, approves the annual budget, requires audited financial statements, and directs Mediation to work with other governments.		Yes		Mediation's governing body is insulated from political influence and risks are not assumed by the federal government.
Bicycle America, Inc. (Scenario A)	No	No. BA is owned by shareholders.	No, governing board members are elected by shareholders rather than subject to political appointment.	No, Management and auditor agreement based on facts and circumstances it was not misleading to exclude.	No. Advisory committee offers advice but does not have the authority to direct BA to act.		
Bicycle America, Inc. (Scenario B)	No	Yes, the federal government acquired 51% of the voting rights in BA.			Yes		Intervention activity—separate legal entity with limited financing from general taxes.
Chatham Laboratory (FFRDC)	No	The assets and research results are owned.	Yes. The federal government establishes the purpose and mission of Chatham.		Yes	Yes, Chatham is primarily funded by taxes, and governance rests with the President and Congress.	

IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?						CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
NAME	**IN THE BUDGET**	**OWNED**	**CONTROL**	**MISLEADING TO EXCLUDE**	**IS THE ORGANIZATION INCLUDED?**	**A CONSOLIDATION ENTITY (CONSOLIDATED)**	**A DISCLOSURE ENTITY (DISCLOSED)**
Gotham Laboratory	No	No	No	No, Management and auditor agreement based on facts and circumstances it was not material to exclude.	No. Although it may be economically dependent, Gotham has discretion as to whether to accept funding from the government.		
Andromeda Prime Power Systems (GSE)	No	No	No, APPS' governing body is elected by common shareholders. The APPS Advisory Board advises Congress and does not direct APPS' operations.		No, Management determined and the auditor concurred APPS should be disclosed as a related party.		
U.S. Museum (Scenario A)	Yes				Yes	Yes. The Museum is in the budget and primarily funded by taxes and governance rests with the President and Congress.	
U.S. Museum (Scenario B)	Yes but as a non-federal organization receiving federal financial assistance.	No	Yes. The President appoints a majority of the governing body's members.		Yes		The museum is a financially independent organization.
Firefighters' Housing Limited Partnership	No	Ownership of property is retained.	Yes. Agency 123 has significant authority to direct the limited partnership's activities and to affect day-to-day activities such as in design and construction and the partnership's purpose is to carry out federal missions and objectives.		Yes	Yes. Taxes fund the housing and risks have been assumed.	

IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?						CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
NAME	**IN THE BUDGET**	**OWNED**	**CONTROL**	**MISLEADING TO EXCLUDE**	**IS THE ORGANIZATION INCLUDED?**	**A CONSOLIDATION ENTITY (CONSOLIDATED)**	**A DISCLOSURE ENTITY (DISCLOSED)**
Blue Mountain Observatory(FFRDC)	No	Property is owned by the federal government.	Yes. The federal government establishes the purpose and mission of BMO.		Yes		BMO is a separate legal entity and UC plays a significant role in its governance without political influence.

Appendix D: Abbreviations

AICPA	American Institute of Certified Public Accountants
C.F.R.	Code of Federal Regulations
CFR	Consolidated Financial Report of the U.S. Government
CRE	Component Reporting Entity
CRS	Congressional Research Service
ED	Exposure Draft
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FFRDC	Federally Funded Research and Development Center
FRS	Federal Reserve System
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPFFR	General Purpose Federal Financial Report
OAI	Other Accompanying Information
OIG	Office of Inspector General
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States
U.S.C.	United States Code

Appendix E: Task Force Members

Owen Barwell, Department of Energy
Lieutenant Colonel Richard Brady, United States Marine Corp, Department of Defense
Terry Bowie, (formerly of) National Aeronautics and Space Administration
James L. Chan, University of Illinois at Chicago
Naresh Chopra, Department of Labor
Wendy Calvin, Department of Transportation
Tom Daxon, Former Oklahoma State Auditor
Ann Davis, U.S. Department of Treasury
Lynda Downing, Government Accountability Office
Abe Dymond, (formerly of) Government Accountability Office
Joel Grover, (formerly of) U.S. Department of Treasury, Office of the Inspector General
Mark Hadley, Congressional Budget Office
Regina Kearney, Office of Management and Budget
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Dan Kovlak, (formerly of) KPMG
Andrew Lewis, KPMG
Rick Loyd, Department of Energy
Ned Maguire, (formerly of) Office of the Dir. of National Intelligence, OIG
Sam Papenfuss, Congressional Budget Office
Reginald Royster, Department of Housing and Urban Development
Fred Selby, (formerly of) U.S. Department of Treasury, Office of Financial Stability
Gary Solamon, (formerly of) Department of Commerce, Bureau of Economic Analysis
Sandy Van Booven, National Reconnaissance Office
Denise Williams, U.S. Department of Treasury, Fiscal Service
Adrienne E. Young, (formerly of) National Science Foundation

Statement of Federal Financial Accounting Standards 48: Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials

Status

Issued	January 27, 2016
Effective Date	For periods beginning after September 30, 2016. Earlier implementation is encouraged.
Affects	SFFAC 3, par. 20, 22, 23-25, 26, 42, 44, and 53.
Affected by	None.
Related Guidance	TR 18, Implementation Guidance for Establishing Opening Balances

Summary

This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. This method is permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

This Statement is intended to provide an alternative valuation method to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3, *Accounting for Inventory and Related Property*.

Table Of Contents

Introduction

Purpose

1. This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials. These assets are addressed in Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property.* While SFFAS 3 addresses six types of tangible property, only inventory, OM&S, and stockpile materials are required to be valued using the “initial amount” measurement approach.[1]

2. The alternative valuation method permitted by this Statement may be applied when a reporting entity is presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

Materiality

3. 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.

[1] The *measurement approach* is how an asset or liability is measured in periods after initial recording-i.e., at the historical cost or initial transaction amount (with subsequent adjustments for amortization, depreciation, or depletion, if applicable) or at an amount, such as fair value, measured at each financial statement date. A different measurement approach may be appropriate for different assets and liabilities. Amounts initially recorded are referred to as the "initial amount" and amounts measured at each subsequent financial statement date are "remeasured amounts." [Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 7a]

Standards

Scope

4. This Statement applies when a reporting entity is presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The application of this Statement based on the second condition is available once per reporting entity.

5. This Statement may only be applied in establishing **opening balances**[2] for the reporting period that the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

6. Reporting entities that meet either condition in paragraph 4 and elect to apply the alternative valuation method in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles.*

Definitions

7. **Deemed Cost**—Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

8. **Opening Balances**—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

[2]Terms defined in the Glossary are shown in bold-face the first time they appear.

[3]Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

9. **Unreserved Assertion**—An unconditional statement.

Alternative Valuation Method for Opening Balances

10. **Deemed cost** is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials for the reporting period when the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

11. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[4]

    a. Standard price (selling price)[5] or fair value[6]

    b. Latest Acquisition Cost[7]

    c. Replacement cost [8]

    d. Estimated historical cost (initial amount)

    e. Actual historical cost (initial amount)

[4]The methods are not listed in order of preference.

[5] The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

[6] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38).

[7] The Latest Acquisition Cost (LAC) Method 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. *FASAB Handbook Glossary as of June 30, 2014*

[8] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

12. Once established using deemed cost, opening balances are to be considered consistent with GAAP. No distinction or breakout of the deemed cost amount in the opening balances is required.

Disclosure Requirements

13. A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

Effect on Existing Standards - Amendments to SFFAS 3, *Accounting for Inventory and Related Property*

14. This section amends SFFAS 3, *Accounting for Inventory and Related Property,* as described in the following paragraphs.

15. Paragraph 20 is replaced with the following paragraph: "**Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost."

16. Paragraph 22, the last sentence is amended by removing "(e.g., a standard cost system)."

17. Paragraphs 23-25 are rescinded to remove the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance).

18. Paragraph 26 is replaced by the following paragraph which expands the exception to valuation in SFFAS 3 to incorporate the Alternative Valuation Method for Opening Balances provided in this Statement.

"26. Valuation Method for Opening Balances and Exceptions to Valuation.

a. **Alternative Valuation Method for Opening Balances.**[9] Deemed cost[10] is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials when a reporting entity is presenting financial statements, or one or more line items addressed by Statement of Federal Financial Accounting Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials,* following generally accepted accounting principles (GAAP) promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in applying an alternative valuation method:

   i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[11] that its financial statements, or one or more line items addressed by SFFAS 48, are presented fairly in accordance with GAAP.

   ii. The application of this method based on the second condition specified above is available once per reporting entity.

   iii. Reporting entities that meet either condition in paragraph 26a. and elect to apply the alternative valuation method in establishing opening balances permitted by SFFAS 48 are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.

   iv. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[12]

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[9]Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[10]Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

[11] An unreserved assertion is an unconditional statement.

[12] The methods are not listed in order of preference.

(1) Standard price (selling price)[13] or fair value[14]
(2) Latest Acquisition Cost[15]
(3) Replacement cost[16]
(4) Estimated historical cost (initial amount)
(5) Actual historical cost (initial amount)

v. Disclosure requirements-A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. **Exceptions to Valuation.** An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:

i. Units of which are interchangeable,

ii. Units of which have immediate marketability,

iii. Units for which appropriate costs may be difficult to obtain."

[13]The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

[14] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)

[15] The Latest Acquisition Cost (LAC) Method 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. *FASAB Handbook Glossary as of June 30, 2014*

[16] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

19. Paragraph 42 is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Operating Material and Supplies."

20. Paragraph 44 is amended by deleting the last sentence: "In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system)."

21. Paragraph 53, the first sentence is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Stockpile Materials." Paragraph 53 is also amended by deleting the last sentence: In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system)."

Effective Date

22. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

<u>Department of Defense Implementation Guidance Request Project</u>

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for the Board's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, provide the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request for guidance on the use of reasonable baseline estimates on the valuation of inventory, operating materials and supplies (OM&S), and stockpile materials from non-GAAP legacy systems. Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, requires valuation at historical cost (initial amounts).

A3. In the initial phase of the project, Board staff met with senior officials from DoD to develop a comprehensive list of inventory valuation methodologies in place and the status of implementation of an SFFAS 3 compliant system for each DoD component.

A4. Based on the meetings and information provided it was determined that:

a. Most DoD component legacy systems have valued inventory, OM&S, and stockpile materials at latest acquisition cost or standard cost (selling price) rather than historical cost. These legacy systems do not maintain a record of the cost of previous purchases. Therefore, DoD does not have the data necessary for revaluing inventory, OM&S, and stockpile materials at transition from a non-GAAP to a GAAP valuation (that is, historical cost).

b. DoD components transitioned from non-GAAP legacy systems to SFFAS 3 compliant systems at different times. While DoD has implemented systems that are SFFAS 3 compliant, it is difficult to determine at what point DoD inventory valuation using a historical cost methodology (for example, moving average cost) will be cleansed (eliminated through turnover) of non-GAAP values derived from legacy systems.

c. DoD components advised that they do not have the information to provide historical turnover rates for the purpose of identifying items that have turnover rates such that the non-GAAP valuation method used prior to the adoption of SFFAS 3 would approximate historical cost.

d. DoD does not have the information for revaluation and it is not practical or cost effective to develop models for revaluation.

Summary of Outreach Efforts and Responses

A5. The Exposure Draft (ED), *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, was issued on June 2, 2015 with comments requested by July 20, 2015.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, FASAB News, the Journal of Accountancy, Association of Government Accountants Today, the CPA Journal, Government Executive, and the CPA Letter, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board.)

A7. This broad announcement was followed by direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations- Sub-Committee on Defense

b. House Committee on Armed Services

c. House Committee on Oversight and Government Reform

d. House Committee on the Budget

e. House Committee on Veterans' Affairs

f. Senate Appropriations- Sub-Committee on Defense

g. Senate Committee on Armed Services

h. Senate Committee on Finance

i. Senate Committee on Homeland Security and Governmental Affairs

j. Senate Committee on the Budget

k. Senate Committee on Veterans' Affairs

A8. The DoD also received the ED.

A9. Twelve responses were received from preparers, auditors, and professional associations. All respondents (with the exception of one respondent that did not specify agreement or disagreement) agreed with the proposal. The respondents identified certain issues that could be clarified within the Statement or addressed in the Basis for conclusions.

A10. The Board did not rely on the number 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 considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. Two respondents requested that aspects of the scope be clarified. After considering the comments, the Board considered options and decided to state consistently the conditions that entities must meet in order to apply the provisions of this Statement rather than attempting to describe the many conditions for which the Statement does not apply. Additionally, the Board believed it should address the applicability of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles* to those reporting entities that meet the conditions and elect to apply the provisions of this Statement. Specifically, paragraph 12 states "…For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13(a) - (c) for all changes in accounting principles:

"(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."

A12. SFFAS 21 provides that 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. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and explain that opening balances of a particular line item or group of line items were valued at deemed cost under this Statement, briefly describe deemed cost, and indicate the effect of adoption on beginning net position.

A13. In addition, changes to the basis for conclusions were made so it did not appear that references to DoD in the basis for conclusions were intended to limit the applicability of deemed cost. While the Statement resulted from a request from DoD, it may be applied to any reporting entity that falls within the scope of the Statement.

A14. During due process, two respondents noted potential confusion due to the similarities between the valuation methods identified for use in arriving at deemed cost for opening balances and with methods identified for use in SFFAS 3. Respondents questioned how the alternative valuation method differs from other valuation methods which approximate historical cost such as latest acquisition cost. They asked whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods.

A15. The Board believes all reasonable methods should be allowed for opening balances. Therefore, the list of potential deemed cost methods remains expansive. This list includes historical cost because deemed cost may be a consolidation of amounts based on historical cost methods and other methods that do not approximate historical cost. Further, some respondents were confused by the references to latest acquisition cost. The Board's intends that latest acquisition cost, without adjustment for unrealized holding gains and losses needed to approximate historical cost, be permitted under the deemed cost method; thus, this method was not a method that approximates historical cost as provided by SFFAS 3.

A16. The Board believes that amending SFFAS 3 to incorporate the alternative valuation approach for opening balances would clarify the intended application and address the concerns raised by respondents. Specifically, removing the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC is equivalent to historical cost (inclusive of the valuation allowance) will avoid potential misunderstandings. The Board believes removing this discussion of LAC will prevent confusion regarding the use of LAC adjusted to approximate historical cost through an allowance for unrealized holding gains or losses as a deemed cost method (not adjusted to approximate historical cost) as provided in this Statement. To assist users, the Board is providing Appendix C: Amendments to SFFAS 3, a marked version of the relevant sections (Inventory, Operating Materials and Supplies, and Stockpile Materials) of SFFAS 3.

A17. In addition, it was suggested the term "may" as used in paragraph 11 regarding the use of valuation methods presents an auditability challenge and respondents recommended it be changed to "should." The Board's intent was to be permissive regarding methods; however, after considering the suggestion that an unacceptable method could be used the language was changed. The Board still believes the standards should provide for all methods, including those that are allowable under SFFAS 3, because this provides flexibility and a cost-effective approach for large and complex organizations to include several valuation methods because the reporting entity may have components using different methods and/or adopting methods permitted under SFFAS 3 at different times.

A18. In addition, four respondents requested clarification on the disclosure requirements. Based on the comments, language was added to the disclosure paragraph to clarify that financial statements of subsequent periods need not repeat this disclosure unless the statements to which deemed cost was applied in establishing opening balances are presented for comparative purposes. One respondent requested clarification on what is meant by first reporting period in relation to interim reporting. The first reporting period would be the first financial statement year end that an unreserved assertion is made. The Board does not believe this would include interim financial statements that presently are unaudited and do not include note disclosures. One respondent requested that the Board consider adding a requirement for the amount of the deemed cost to be disclosed. The Board considered carefully the disclosures that would provide the most meaningful information when developing the Statement. Considering the intent and purpose of this Statement, the Board does not believe such a disclosure would add sufficient value to warrant the significant effort and costs.

A19. During due process, three respondents requested the term "unreserved assertion" be defined. The Board revised the Statement to include a definition of the term. Additionally, a respondent suggested that certain entities' management (such as DoD) may be required to make assertions regarding its financial information. An example is management assertions that DoD financial statements are validated as ready for audit by not later than September

30, 2017. This Statement refers to an unreserved assertion that the reporting entity's "financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP." Other assertions - such as being ready for an audit - may or may not accompany such an assertion. Other minor changes were made to the Statement as suggested by respondents that improved the clarity of the document and terms.

Alternative Valuation Method

Consideration of Other Accounting Standards

A20. During deliberation on the project, the Board considered the recently issued International Public Sector Accounting Standards (IPSAS) No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board (IPSASB) reached several relevant conclusions with IPSAS No. 33:

a. Use of deemed cost facilitates the introduction of IPSASs in a cost effective way.

b. Multiple options for deemed cost are appropriate.

c. The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.

d. Use of deemed cost does not affect fair presentation.

A21. The Board believes that it should take an approach similar to the IPSASB standard. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for inventory, OM&S, and stockpile materials. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances.

Alternative Valuation Method for Opening Balances

A22. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for inventory, OM&S, and stockpile materials addressed in SFFAS 3 for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

A23. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances. Therefore, most often deemed cost will be based on the reporting entity's valuation method or system used for managing inventory, OM&S, and stockpile materials prior to the adoption of SFFAS 3.

A24. Large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 3 at different times prior to establishing opening balances. Deemed cost may be one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 3.

A25. Opening balances in this Statement are the balances at the beginning of the first reporting period when the entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are fairly presented in accordance with GAAP. Once established using deemed cost, opening balances are to be considered consistent with historical cost requirements of SFFAS 3.

A26. Opening balances, established by application of this Statement, should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had a GAAP valuation method been used. Further, no distinction or segregation of amounts arising from the opening balances is required. For example, cost of goods sold using deemed cost need not be distinguished from cost of goods sold at historical cost under a first-in first-out approach. The purpose of this Statement is to provide an alternative valuation method for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of individual types of inventory, OM&S, and stockpile materials, acceptance of non-GAAP values at the transition point to SFFAS 3 compliant systems is the most cost-effective approach.

A27. However, all activity after the opening balances for inventory, OM&S, and stockpile materials are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.

Implementation by Component Reporting Entities

A28. As stated above, complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Further, reporting entity components may have transitioned to an SFFAS 3 valuation method at different times; however, some components established balances for existing inventory, OM&S, and stockpile materials at the time of transition using methods that were not in accord with SFFAS 3. Therefore, given the timing of the transition to an SFFAS 3 valuation methodology, opening balances for the reporting entity may be based on transitional values based on one of the other methods listed in paragraph 11 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.

A29. A component reporting entity that is in the process of implementing systems that are SFFAS 3 compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A30. Using the DoD example, certain DoD components may have transitioned at an earlier date to SFFAS 3 compliant systems; this allows them to assert independently of the larger DoD. DoD would make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

A31. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election since it may only be made once. A complex entity should work with its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities should ensure issues such as supporting documentation for opening balances established are addressed and validated through sampling or other means, including consideration of any audit findings or conclusion affecting the reliability of the valuation, prior to making the unreserved assertion. The importance of a reporting entity being prepared to make the unreserved assertion is critical because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the FY 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for FY 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to:

a. continue in subsequent years to correct or support the valuation as of the beginning of FY 2018, or

b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 3 (as amended), in all material respects.

Disclosure Requirements

A32. The election to apply the provisions of this Statement (deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials) should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required.

A33. The Board discussed that, with time, the valuation of inventory, OM&S, and stockpile materials will not be materially different than historical cost because the older inventory may be consumed. If reporting entities are able to document that turnover rates for inventory, OM&S, and stockpile materials are such that the opening balance valuation is at historical cost, a reference to deemed cost would not be required. This Statement, however, does not impose a requirement that reporting entities engage in an effort to conclude that the use of deemed cost is no longer necessary.

Board Approval

A34. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

APPENDIX B: ABBREVIATIONS

DoD	Department of Defense
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
LAC	Latest Acquisition Cost
OM&S	Operating materials and supplies
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: AMENDMENTS TO SFFAS 3

Appendix C was provided to assist users. It provides a marked version of relevant sections of SFFAS 3. Because the FASAB Handbook presents texts as amended. SFFAS 3 has been updated. Users may view Appendix C as presented in SFFAS 48 on the Original Standards Webpage at http://fasab.gov/standards.

Statement of Federal Financial Accounting Standards 49: Public-Private Partnerships: Disclosure Requirements

Status

Issued	April 27, 2016
Effective Date	For periods beginning after September 30, 2018. Early adoption is permitted.
Affects	None
Affected by	None.

Summary

This Statement establishes principles to ensure that disclosures about Public-Private Partnerships (P3s) are presented in the reporting entity's general purpose federal financial reports (GPFFRs). The principles guide financial reporting by establishing a P3 definition and identifying risk-based characteristics that need to exist before considering the P3 arrangement or transaction for disclosure.

This Statement exempts certain arrangements or transactions from the P3 disclosure requirements contained herein. Such exempt arrangements or transactions are subject to existing disclosure requirements in other Statements of Federal Financial Accounting Standards (SFFAS) applicable to such arrangements or transactions.

This Statement provides for first determining those arrangements or transactions that are exempt from the provisions of this Statement before proceeding to the P3 definition. Federal P3s are defined as "risk-sharing[1] arrangements or transactions lasting more than five years between public and private sector entities." Arrangements or transactions meeting the P3 definition are then evaluated against risk-based characteristics referred to as "Conclusive Characteristics." Should the arrangement or transaction not meet any one of the Conclusive Characteristics required for disclosure, the arrangement or transaction should then be evaluated against the "Suggestive Characteristics" before concluding whether disclosure is required. If an arrangement or transaction warrants reporting, the disclosures should be provided.

Disclosure requirements comprise quantitative and qualitative information to assist users in understanding the nature of P3s such as the relative benefits/revenues being received in

[1] Risk-sharing exists when a public sector entity shares risks and rewards with a private sector entity whenever the benefits of the arrangement or transaction accrue to both the private sector entity and the public sector entity and (1) the public sector entity is at risk of loss, or (2) the private sector entity's ability to perform is at risk and success of the arrangement or transaction depends upon the public sector's intervention.

exchange for the government's consideration, the contractual terms governing payments to and from the government, and related risks including those deemed remote. Disclosures can be provided by individual P3 or summarized; for example, by an entity's strategic objectives, departmental or bureau categorizations, or program budget classifications.

This Statement helps achieve the operating performance and budgetary integrity objectives outlined in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, by making P3s more understandable. P3 information is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. Moreover, because P3s are a form of investment, they should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are being managed and (b) the identification of risks.

This Statement is effective for periods beginning after September 30, 2018. Earlier implementation is permitted.

Table of Contents

Introduction

Purpose

1. To meet challenges such as those brought about by limited budgetary resources governments are increasingly establishing risk-sharing arrangements or transactions[2] with the private sector. Some of these arrangements or transactions may also involve private financing and enable governmental agencies to fulfill their missions to their constituents that would otherwise not be possible without such arrangements or transactions.

2. These risk-sharing arrangements or transactions are commonly referred to as **Public-Private Partnerships (P3s)**[3] but may also be referred to as Alternative Financing Arrangements, or Privatization Initiatives, some of which are extremely complex. For example, P3s may involve the use of appropriated funds, non-appropriated funds, third-party financing, or significant amounts of private capital or investment. Furthermore, P3s can (1) be so long-term in nature that costs along with the accompanying benefits may not be distributed equitably across generations, (2) exclude contractual protections afforded the government by the Federal Acquisition Regulation (FAR) such as, but not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability, and (3) require the government to provide resources or absorb losses greater than other alternative procurement methods or competing in-house performance.[4] Lastly, P3s may involve the transfer of government assets, including intellectual property, into private hands for extended periods of time.

3. As a result, the Board recognizes that the accounting and reporting issues related to risk-sharing can also be extremely complex, involving a wide array of assets and liabilities. P3s by their very design transfer or share various forms of risk among the P3 partners. Such risk allocation strategies are in essence the very incentives that serve as the foundation or building blocks for P3s. Therefore, an entity should understand how much (total) risk resides in an arrangement or transaction and how much of that risk has been (1) transferred to the

[2]Risk-sharing can be either structural or transactional. P3 Structural Arrangements are external to the government entity's operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP). For example, military base housing. P3 Transactional Arrangements are internal to the government entity's operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP.

[3] Terms defined in the Glossary are shown in bold-face the first time they appear.

[4] In-house refers to using government facilities and personnel as opposed to relying on commercial sources to supply the products and services the government needs.

private partner, (2) shared with the private partner, and (3) retained by the entity (that is, the government sponsor). Such an understanding relies on a thorough analysis of the underlying contractual agreements, guarantees, insurance, and indemnification strategies as well as the existence and nature of any underlying private party capital buffer that might exist; that is, the extent of any debt (for example, bonds, loans and notes) and equity (for example, stocks, and other securities representing an ownership interest) participation.

4. Entities can execute P3s via **structural arrangements** through the use of **special purpose vehicles (SPV's)** and/or directly as **program transactional arrangements.** Furthermore, many P3s are either discrete (long-term) leases or involve aspects of leasing.

5. The Board has previously addressed various types of long-term arrangements or transactions in which the government participates (for example, leases or guarantees). As such, accounting standards exist that provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. This Statement supplements existing guidance to help ensure adequate disclosure of those arrangements/transactions that either form the basis of or are part of a P3. Therefore, existing accounting standards that govern the various types of long-term arrangements/transactions continue to apply.

6. To that end, the Board notes that there are risks associated with P3s. For example, risks (1) where actual costs will be greater than budgeted costs, (2) the entity may have to absorb part or all of the project's private debt, (3) the entity will not achieve expected returns on its investments in limited partnerships, (4) conditions may lead to a government-acknowledged event where an entity assumes financial responsibility for the event, and (5) the public purpose or public value will not be fulfilled or achieved. Because of the risks involved in entering into such long-term agreements, some of which involve government assets, specific disclosures regarding P3s are needed. Such disclosures foster accountability and improve understanding of (1) the general risks inherent in P3 arrangements by revealing their purpose, objective, funding, operational and financial structures; and (2) contractual risks of loss such as early termination requirements. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements.

7. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. Some risks associated with P3s may result in the incurrence of losses and applying Statement of Federal Financial Accounting Standards 5 (SFFAS 5): *Accounting for Liabilities of the Federal Government* would be appropriate. For recognition of losses, SFFAS 5 requires that a past event has occurred for which a future outflow or other sacrifice of resources is probable and measurable. Disclosure should be provided for reasonably possible losses and probable losses that are not measureable.

8. Due to their very nature, P3s are used to manage risks, some of which may be risks of loss included in the terms of the contractual P3 arrangements or transactions that are deemed remote but are nonetheless material and may require disclosure. For example, excluding contractual protections afforded the government by the FAR[5] inherently increases the entity's risk as does a relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. It is the Board's opinion that remote risks of loss included in the terms of the contractual P3 arrangements or transactions that are material should be disclosed. Therefore, consideration should be given to those risks that management does not expect to be likely yet could represent a risk of loss to the entity. With this being said, the Board also recognizes that (1) certain remote risks may have a reasonably high materiality threshold and (2) not all individual remote risks in a P3 arrangement or transaction need to be disclosed to satisfy the requirements of this Statement. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

9. Disclosures comprise quantitative and qualitative information and not all P3 risks can be readily or sufficiently measured. However, federal financial reports are most likely to meet reporting objectives and, therefore, user's needs when disclosures help readers understand complex arrangements or transactions and the associated risk. To this end, qualitative disclosures are as important as quantitative disclosures. Further, both quantitative and qualitative factors should be considered in assessing materiality as well as the nature and content of information to be disclosed.

10. Because the Board has identified the need for clarity with respect to questions that arise concerning the full costs including risk of these complex arrangements or transactions, this Statement is a first step toward developing principles-based guidance and identifying potential gaps in existing guidance. The Board is working and will continue to work closely with stakeholders interested in improving the accounting and reporting of these complex arrangements or transactions. By addressing disclosure issues as a first step, the Board will facilitate continued cooperation and greater interest in identifying areas requiring attention while minimizing preparer burden. It should be noted that the Board also plans to address measurement, recognition, and reporting issues through continued consultation with stakeholders. This could lead to the issuance of additional guidance.

[5]For example, contractual protections afforded the government by the FAR include but are not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability.

MATERIALITY

11. The provisions of this Statement need not be applied to immaterial items. However, materiality should be applied cumulatively or in the aggregate by the entity. 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. Refer to paragraphs 8 and 9 above for related comments.

Standards

SCOPE

12. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board.*

13. This Statement is applicable to public-private partnerships (P3s) and this term is used to refer to a wide variety of service, management, operating, and research and development arrangements or transactions meeting the definition of P3s presented in paragraphs 16 through 18.[6] Such arrangements and transactions may include contracts, grants, reimbursable agreements, alternative financing arrangements, privatization initiatives, and other arrangements or transactions.

14. Some P3s can result in risk of loss and therefore should be assessed against the risk based (conclusive and suggestive) characteristics at paragraphs 20 and 21 to identify those that should be disclosed.

15. The following arrangements and transactions are not subject to the provisions of this Statement:

    a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

[6] For purposes of this Statement, the private sector refers to individuals and entities acting in their private capacities outside of the authority and control of federal, state, or local governments and encompasses for-profit businesses and non-profit organizations that are outside of the authority and control of federal, state or local governments.

b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

c. Acquisition of supplies and services, including construction, research and development, and commercial items, made pursuant to the FAR Simplified Acquisition Procedures (FAR Part 13)

d. Formal and informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, or coordinate and integrate strategic initiatives

e. Grants to state, local, and Indian tribal governments and other public institutions and arrangements or transactions with foreign governments

f. Arrangements or transactions in which private entities voluntarily contribute nominal resources or provide incidental resources without expectation of compensation or government indemnification for any possible risk of loss

[7] The term leases includes enhanced use leases and both capital and operating leases, as defined under current FASAB standards.

[8] A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, software updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

Definition

16. Subject to the exclusions noted in paragraph 15 and for the purposes of this Statement, federal public-private partnerships (P3s) are risk-sharing[9] arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

17. A public sector entity shares risks and rewards with a private sector entity whenever the benefits of the arrangement or transaction accrue to both the private sector entity and the public sector entity and (1) the public sector entity is at risk of loss, or (2) the private sector entity's ability to perform is at risk and success of the arrangement or transaction depends upon the public sector's intervention.

18. The expected life of a P3 is the term or period for which the entity, including consideration of economic incentives, is likely to participate in the P3. The expected life is initially determined at the inception of the P3 arrangement when the economic incentives are identified and considered in the formation of the P3. Economic incentives considered may include expected significantly reduced costs or increased efficiencies if contracts are renewed or if the P3 approach is continued realization of return on investment, continuity of mission critical services, flexibility, and significant costs associated with nonrenewal, such as required payments at the end of the contract to compensate the private party for significant capital investments. Typically, expected life is documented in budget justifications, cost benefit or value for money analyses, or other analyses. Expected life may extend beyond the current contract period (including options or renewals). Expected life is re-evaluated as P3 contracts are renewed and when the entity identifies significant changes in circumstances during the contract period that may affect the expected life.[10]

19. Arrangements or transactions which are not excluded by paragraph 15 and meet the definition in paragraphs 16 through 18 should be assessed against the risk based characteristics in paragraphs 20 and 21.

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[9] Risk-sharing can be either structural or transactional. P3 Structural Arrangements are external to the government entity's operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP); for example, military base housing. P3 Transactional Arrangements are internal to the government entity's operations; for example, work-share programs not involving the creation of a SPV, Trust, or LP.

[10] The Basis for Conclusions (BFC) paragraph A41 provides examples regarding determination of a P3's expected life.

Identification of P3'S Requiring Disclosure

20. The following risk characteristics are conclusive evidence that P3s possess risk of loss indicating that disclosures should be provided. If any one of the following conclusive risk characteristics is met, the P3 arrangement or transaction should be disclosed.

Conclusive Risk Characteristics	Risk Rationale[11] [11] The rationale presented herein explains why the Board believes there is or may be risk of loss when the characteristic is present. The rationale discusses risk broadly and is not intended to create specific disclosure requirements. The disclosures are articulated in paragraph 24. Please refer to BFC paragraphs A37 through A43 for related comments.
1. The arrangement or transaction results in the conveyance or creation of a long-lived asset or long-term financing[12] liability. [12] Contractors routinely finance operations while awaiting payment of invoices. Such routine financing is not indicative of a P3 in and of itself.	Not all P3s result in the conveyance or construction of an asset. However, in those that do, the government's risk may be significantly increased because of costs that accompany asset ownership or control. Further, financing may be provided in whole or shared in part by private sector entities. Note that some private partners may incur substantial financing liabilities in preparation for delivering services even if an asset is not created.
2. The federal entity participates in, helps sponsor, or is party to a Special Purpose Vehicle (SPV), partnership, trust, and other such arrangements.	Entities such as SPVs, partnerships, trusts, and other such arrangements can be established for a variety of strategic and/or tactical reasons. Generally speaking, they are commonly considered risk-containment vehicles and are more often than not, purposefully not included in budgets or balance sheets. P3s employing SPVs, partnerships, trusts, and other such arrangements can be or most often become borrowing arrangements/transactions or alternative financing mechanisms. Therefore, the risk rests in the fact that because SPVs, partnerships, trusts, and other such arrangements can facilitate funding/financing, an agency's explicit or implicit long-term debt or promise to pay the established entity is not appropriately recognized in either budget or financial reports.
3. The arrangement or transaction covers a significant portion of the economic life of a project or asset.	Those P3 procurement or contract arrangements/transactions that cover a significant portion of the economic life of a project or asset pose greater risk to the federal entity because there is often no re-procurement or re-negotiation opportunity for the agency. As a result, changed conditions that could warrant a fair and reasonable re-negotiation or re-competition cannot be exercised and increased costs that would otherwise be avoided are incurred for the duration of the arrangement/transaction.

4. The principal arrangement or transaction is exempt from: a. if a contract, the FAR; or b. b. if a grant, Office of Management and Budget (OMB) requirements (2 C.F.R. Title 2, Part 200).	The FAR for contracts and OMB requirements for grants govern the administrative framework and include procurement, accounting, and legal requirements to help safeguard taxpayer dollars. Therefore, those P3s exempt from such requirements are at an increased-risk because well-established safeguards and contract resolution mechanisms are absent.

21. The following risk characteristics are evidence that P3s may possess risk of loss and require disclosure. The following suggestive risk characteristics should be considered in the aggregate. Each suggestive risk characteristic will require entity judgment as each characteristic is analyzed in connection with the other suggestive risk characteristics.

Suggestive Risk Characteristics	**Risk Rationale**[11] [11]The rationale presented herein explains why the Board believes there is or may be risk of loss when the characteristic is present. The rationale discusses risk broadly and is not intended to create specific disclosure requirements. The disclosures are articulated in paragraph 24. Please refer to BFC paragraphs A37 through A43 for related comments.
1. A Value for Money (VfM)[13] analysis is performed. [13] In its publication "The Value for Money Analysis: A Guide for More Effective PSC and PPP Evaluation," the National Council of Public Private Partnerships adopted the United Kingdom's, Her Majesty's Treasury Value for Money definition as contained in Her Majesty's Value Assessment Guide: VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be.	The term VfM is commonly used in connection with P3 arrangements or transactions. VfM analyses are broader in scope emphasizing qualitative factors, as opposed to the more traditional quantitatively based cost-benefit analyses most often performed. If an entity conducts a VfM analysis it may indicate that the project in question is a P3. VfM's are typically more subjective than traditional cost-benefit analyses and are sometimes prepared ex-post facto, thus increasing potential risk to the agency.
2. The consideration or items given up in an arrangement/transaction or their value are not readily apparent.	Generally under common law, consideration from both parties is required in order to have what constitutes a binding contract. Some courts have ruled that in those cases where the exchange appears excessively one sided, no quid-pro-quo exists and the contract may be void by law. Therefore, in those cases where consideration or its value from either party is not readily apparent, such cases could lead to recourse or remedies that have adverse financial ramifications to the agency.

3. Significant work force duties, activities, or knowledge are cross-shared between public and private sector P3 parties.	As federal entities face under-utilization and skill retention issues, with Congressional approval, some entities are entering into P3 arrangements/transactions to put both infrastructure and government personnel to heightened work. However, there is a concern that the analyses used to justify these arrangements or transactions often exclude government personnel costs, including associated legacy costs (for example, pension and OPEB). Therefore, increased risk exists in those cases where such costs are excluded from cost-benefit or VfM analyses because the government (1) is left absorbing these costs with no related activity base, (2) is exposed to potential liabilities arising from union and/or employee litigation, and (3) may lose governmental skill-sets that would lead to costlier procurement options.
4. The focus is more on collaboration and informal, real-time, resolution processes than on formal, contractual, administrative processes.	Due to their very nature, P3 arrangements or transactions involve risk-sharing and in some cases, issues such as contract disputes are resolved informally. However, such informal resolution processes could lead to potential liability when contracting, procurement, or legal personnel are not involved. Therefore, the risk rests in the potential liability arising from informal resolution of what otherwise would require more formal contractual administrative processes.
5. The government relies on either the private sector partner's or a third party's determination of a P3's performance or return on investment/equity without performing its own verification of performance or return on investment/equity.	Agencies often rely on 3rd party experts to assist in performing various types of analyses. It has been noted that conflicts of interest often exist because there are only a few firms who practice in this highly sophisticated area. As a result, some firms have provided advisory services to both the private partner and government sponsor of a P3 arrangement/transaction. In addition, fees are often based on the dollar volume of the arrangement/transaction creating what some believe are self-serving incentives. Therefore, the risk in those P3 arrangements/transactions rests where an agency does not or cannot perform its own independent analysis, thus relying solely on either the private partner or a third party determination of a P3's performance or return on investment/equity without performing its own verification. Such analyses may belie the significant risk the government has or will incur.

Disclosure Requirements

Component Reporting Entity Disclosures

22. The P3 disclosures at paragraph 24 below specify the inclusion of qualitative and quantitative information and may be aggregated or grouped by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, or other means.

23. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements. Depending on the circumstances, some of the required information may be disclosed due to other requirements. The resultant disclosures should be integrated so that concise, meaningful, and transparent information is provided and information is not repetitive.

24. Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a P3 arrangement/transaction. The following information should be disclosed:

    a. The purpose, objective, and rationale for the P3 arrangement or transaction and the relative benefits/revenues being received in exchange for the government's consideration, monetary and non-monetary; and the entity's statutory authority for entering into the P3.

    b. A description of federal and non-federal funding of the P3 over its expected life, including the mix and, where available, the amounts of such funding. For any amounts that are not available, the disclosures should indicate such.

    c. The operational and financial structure of the P3 including the reporting entity's rights and responsibilities, including:

        i. A description of the contractual terms governing payments to and from the government over the expected life of the P3 arrangement or transaction to include:

            1. explanation of how the expected life was determined

            2. the time periods payments are expected to occur

            3. whether payments are made directly to each partner or indirectly through a third-party, such as, military housing allowances

4. in-kind contributions/services and donations

ii. The amounts received and paid by the government during the reporting period(s) and the amounts estimated to be received and paid in aggregate over the expected life of the P3

d. Identification of the contractual risks of loss the P3 partners are undertaking

i. Identification of such contractual risks of loss should include a description of (1) the contractual risk and (2) the potential effect on cash flows if the risks were realized (for example, early termination requirements including related exit amounts and other responsibilities such as asset condition (hand-back) requirements, minimum payment guarantees, escalation clauses, contingent payments, or renewal options).

ii. Disclosure of remote risks of loss should be limited to those included in the terms of the contractual P3 arrangements or transactions. If remote risks of loss are disclosed, an explanation should be included that avoids the misleading inference that there is more than a remote chance of a loss.

e. As applicable:

i. Associated amounts recognized in the financial statements such as gains or losses and capitalized items

ii. Significant instances of non-compliances with legal and contractual provisions governing the P3 arrangement or transaction

iii. Whether the private partner(s), including any Special Purpose Vehicle (SPV), have borrowed or invested capital contingent upon the reporting entity's promise to pay whether implied or explicit

iv. Description of events of termination or default

Financial Report of The U.S. Government Disclosures

25. The U.S. government-wide financial statements should disclose:

    a. a general description of P3 arrangements or transactions
    b. the consolidated amounts the government received and paid during the reporting period(s) and estimated to be received and paid in aggregate over the expected life of the P3s
    c. a reference(s) to applicable component entity report(s) for additional information

Effective Date

26. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Early adoption is permitted.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. This project was added to the FASAB's technical agenda in April 2012 because federal agencies have increasingly turned to public-private partnerships to accomplish goals and in light of budget pressures likely to further increase their use. Although federal generally accepted accounting principles are fairly robust, the Board noted that due to the complex nature of P3s significant study would be required regarding a host of issues dealing with the definition, measurement, and recognition of P3s. In December 2012, the project plan was adopted with the overall goal of recognizing the full costs of P3s in the financial statements. In addition, a P3 task force was formed and held its first meeting in February 2013.

A2. Final standards or guidance were expected to follow a three year effort. Specific project objectives include:

a. Defining terms

b. Providing guidance (that is, identifying gaps) for the recognition and measurement of:

i. assets and liabilities

ii. revenues and expenses

iii. establishing disclosure requirements

c. Considering guidance for other arrangements/transactions related to P3s (for example, sale-leaseback or other long-term arrangements)

A3. Early in its deliberations the Board was clear that forthcoming guidance must be consistently applied and covered by an overarching principle(s). The Board noted its concern is with the risks to which the government is exposed and related disclosures. As a result, members decided that because P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements, these complexities necessitate the establishment of disclosure requirements as a first step to (1) developing uniform, principles-based guidance, and (2) identifying potential gaps in existing guidance. To that end, the Board decided that a broad P3 definition accompanied by risk-based characteristics should be pursued to establish a framework for determining which P3s should be disclosed. The Board believes that the resulting disclosures will inform the need for and development of future standards providing recognition and measurement guidance specific to P3s. Therefore, any further work will be undertaken after these disclosures become effective.

A4. P3 task force meetings for this phase of the project were held between February 2013 and May 2014. All meetings were well attended with representation from federal agencies, commercial sector(s), and citizens. Participants came from diverse disciplines such as accounting, auditing, facilities management, financial reporting, housing, information technology (IT), commercial and investment banking, procurement, and program management. To best meet the project goals and objectives, staff, in addition to engaging in task force discussions, initiated fact-finding meetings with experts and practitioners both within and external to government. Staff met with federal agency representatives, public policy experts, consultants, private equity participants, and a private IT/Cloud/Software development firm.

Common Themes and Other Matters

A5. The most common themes arising from task force and fact finding meetings considered in developing the Statement include:

a. At a minimum, participants expect continued use if not growth in P3s.

b. Government employee legacy & relocation costs are not presently considered in Value for Money (VfM)[14] analyses.

[14] VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability. The VfM concept has drawn criticisms not only because of its subjectivity and lack of rigor in application, but because in some cases (1) cash flows can be easily managed to meet desired expectations and (2) VfM results are used as ex-post facto justifications for qualitatively made project and/or award decisions. It is important to note that the same criticisms can be made of the more traditional cost-benefit analyses used in management decision making.

c. Long-term nature of P3s is accepted, but concerns include

i. lack of transparency in the solicitation and award processes along with the lack of competition hinders accountability and fair and reasonable pricing,

ii. not applying the Federal Acquisition Regulation[15] (FAR) increases government risk, and

iii. some P3s circumvent procurement administration.

d. In-kind contributions are difficult to value or are overvalued and not always reported.

e. P3 financial reporting is generally supported but agencies and participants vary in the what, how, and where of disclosures. For example, relative to significant and material P3 arrangements or transactions, some believe that property, plant, and equipment (PP&E) note disclosure would be sufficient whereas others believe that MD&A discussion is more appropriate because of the SFFAS 15, *Management's Discussion and Analysis*, requirement to address the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends, while others suggest reporting in both locations.

A6. Other matters arising during task force and fact finding meetings included:

a. **Increased Risk to Citizens.** A few participants noted that P3s erode (1) the notion of public service (for example, what is inherently governmental) and (2) in many cases, belief in good government. This increased risk is evidenced by those entities that:

i. purposefully avoid capital acquisition budgeting requirements

ii. absorb "availability" risk[16] absent sufficient private partner consideration

[15]The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. It became effective on April 1, 1984, and is issued within applicable laws under the joint authorities of the Administrator of General Services, the Secretary of Defense, and the Administrator for the National Aeronautics and Space Administration, under the broad policy guidelines of the Administrator, Office of Federal Procurement Policy, Office of Management and Budget.

[16]Availability risks or project completion risks exist when for example, defects in construction or quality shortfalls within the control of the private partner occur that preclude the asset or service from being available for its intended use requiring the government sponsor to intervene.

iii. lose control of assets

iv. lock into long-term arrangements/transactions that cannot be re-competed or re-negotiated

v. are constrained by contract modification restrictions

vi. are constrained by proximity and/or right-to-compete restrictions

vii. ignore government employee personnel (legacy) costs

b. **Financing costs.** To enable private financing to work, P3's must be longer-term in nature to allow for sufficient time to liquidate debt and achieve return on investment targets. This is significantly different than traditional procurement contract periods that are typically 5 years or less.

c. **Performance Metrics.** Financial reporting would be enhanced by incorporating performance metrics that could point to both risks and potential liabilities as they arise.

Summary of Outreach Efforts

A7. The ED was issued October 1, 2014 with comments requested by January 2, 2015. Upon release of the exposure draft, notices and press releases went to the following organizations:

a. The *Federal Register*

b. *FASAB News*

c. The *Journal of Accountancy, AGA Today, the CPA Journal, Government Executive and the CPA Letter*

d. The CFO Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network; and members of both the Federal Real Property Council and Federal Facilities Council

e. Committees of professional associations generally commenting on exposure drafts in the past

A8. This broad announcement was followed by electronic mailings of the exposure draft followed up by several reminder notices.to:

a. Relevant congressional committees

   i. House Committee on Oversight and Government Reform

   ii. Senate Committee on Homeland Security and Governmental Affairs

b. Public interest and labor union groups

   i. In the Public Interest

   ii. American Federation of State, County and Municipal Employees

A9. The Board did not rely on the number 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 considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

A10. The exposure draft was issued with an alternative view that expressed concerns over the (1) breadth of the general definition, (2) disclosures related to certain remote risks, and (3) clarity of "significant exposure." Specific comments regarding respondent concerns and Board re-deliberations are noted in the following paragraphs as appropriate.

Definition: Public-Private Partnerships

A11. In consultation with constituents to include respondent comments received and related outreach concerning the breadth and scope of the definition, the Board has further developed and refined the definition proposed in the exposure draft. The Board desired establishing a definition that (1) reflected actual federal P3 practices, (2) covered the wide breadth and diverse scope of federal assets, and (3) focused on the risk-sharing or risk transfer strategies that are the very essence of these complicated arrangements or transactions. The definition is intended for general application to be applied uniformly across the federal government.

A12. In reviewing the P3 definitions of other standard-setters, the Board notes that their guidance is largely focused on service concession arrangements (that is, a sub-set of P3s) that directly benefit the general public. The definition contained in this Statement is much broader given the wide breadth and diverse scope of federal assets being managed. It is important to note that (1) federal preparers and auditors have identified accounting topics that extend beyond those typically found in service concession arrangements, (2) oversight entities such as the Congressional Budget Office, GAO, and inspectors general have defined and identified P3 arrangements or transactions to be more than just service concessions, and (3) service concession accounting guidance primarily reflects economic development initiatives such as new roads, toll roads, highways, airports, railways, and hospitals, whereas federal initiatives extend well beyond economic development such as the common defense and general welfare of the nation thus necessitating accounting guidance to best fit these federal initiatives.

A13. In developing the definition, the Board primarily relied on (1) the task force's review of existing definitions from several authoritative sources, (2) various respondent comments to the definition contained in the exposure draft, and (3) an ad-hoc working group comprised of selected respondents. The task force identified the more common characteristics of P3s which are believed to exist in the federal government. Some of the more common P3 characteristics identified include: existence of very long-term contractual agreements (for example, anywhere from five to 99 years), shared or transferred financing, agreements covering a significant portion of the project's or asset's life, shared risks, shared rewards, shared skills and expertise, conveyance or creation of real and personal property, and the use of SPVs. Those respondents specifically commenting on the definition as well as the ad-hoc working group primarily suggested better linkage between the definition and the risk-based characteristics. Accordingly, the broad definition contained in the exposure draft was further refined and is as follows:

> Subject to the exclusions noted in paragraph 15 and for the purposes of this Statement, federal public-private partnerships (P3s) are risk-sharing arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

Scope, Applicability and Exclusions

Scope

A14. The Board recognizes that establishing a P3 definition reflecting the breadth and diverse scope of entity missions, operational strategies, available leasing authorities, and other variables might capture activities which are already being recognized or disclosed in the entity's financial statements. Specifically, this is because the Board has previously addressed various types of long-term arrangements/transactions in which the government participates (for example, leases and guarantees). As such, existing accounting standards provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. However, the Board believes that there is a need for disclosure requirements specific to the risks existing in P3s for which there is no current accounting guidance. The requirements herein do not replace existing disclosure requirements in other SFFASs for similar arrangements or transactions such as leases. P3s are complex arrangements/transactions and an entity would apply all applicable standards to report relevant information in the notes.

Applicability

A15. To help ensure achievement of the federal reporting objectives while minimizing unwarranted disclosure of P3 arrangements or transactions, the Board has established filters at several decision points to aid preparers in this regard. The filters are categorized as follows:

a. Definitional Features Indicative of Risk - After careful study the Board initially identified four major features of federal P3 arrangements or transactions that were embodied in the proposed definition: (1) agreements covering a significant portion of the economic life of a project or asset, and/or lasting more than five years, (2) financing provided in whole or shared in part by the private partner, (3) conveyance or transfer of real property, personal property, or multi-sector skills and expertise, and (4) formation of SPV's. However, as a result of respondent comments concerning linkage between the definition and the risk-based characteristics and a working group recommendation, the Board (1) realigned the four major features by incorporating them directly into the risk-based characteristics and (2) within the definition, specifically excluding arrangements or transactions which are not more than 5 years in duration.

b. Risk-based Characteristics - The Board has identified and refined during its re-deliberations certain key characteristics discussed later that reflect varying degrees of risk that exist in federal P3s. Therefore, should these characteristics be absent in a P3, the disclosure requirements of this Statement would generally not apply.

c. Materiality - As is the custom with all Statements issued by the Board, only those P3s that are material (qualitatively and quantitatively) in nature, more thoroughly discussed later, should be subject to the requirements of this Statement. The Board notes that because materiality assessments require both qualitative and quantitative judgments, specific guidance limiting preparer and auditor considerations of information would not be appropriate.

Exclusions

A16. As a result of respondent comments concerning the breadth of the proposed definition, the ad-hoc working group recommended and the Board adopted three additional exclusions. The three additional exclusions are:

a. grants to state, local, and Indian tribal governments and other public institutions,

b. arrangements or transactions with foreign governments, and

c. arrangements or transactions sharing nominal or incidental resources.

The first two exclusions identified above reflect that this Statement only applies when a federal entity is in a risk-sharing arrangement or transaction with the private sector[17] and not a public sector institution. Risks associated with public-to-public partnerships (for example, federal to state or federal to local) and those associated with foreign governments (1) are significantly different when compared to risks arising in public-private partnerships and (2) warrant extensive research far beyond the scope of this Statement. Moreover, arrangements or transactions with Indian tribal governments or foreign governments are closely governed by selected agencies and Congressional committees and are also beyond the scope of this Statement. Lastly, arrangements or transactions in which private entities voluntarily contribute nominal resources or provide incidental resources without expectation of compensation or government indemnification for any possible risk of loss are also excluded from the requirements of this Statement.

A17. In summary, the following arrangements or transactions are excluded from the requirements of this Statement:

a. non-lease acquisitions of property, plant, and equipment that are subject to the FAR and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction,

b. leases meeting certain conditions,

c. acquisitions made using Simplified Acquisition Procedures (FAR Part 13),

d. formal and informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, or coordinate and integrate strategic initiatives,

e. grants to state, local, and Indian tribal governments and other public institutions and those with foreign governments, and

[17] For purposes of this Statement, the private sector refers to individuals and entities acting in their private capacities outside of the authority and control of federal, state or local governments and encompasses for-profit businesses and non-profit organizations that are outside of the authority and control of federal, state or local governments.

f. arrangements or transactions sharing nominal or incidental resources.

A18. Concerning leases, in consultation with the P3 Task Force and after careful consideration, the Board concluded:

a. to exclude leases[18] that meet the following two conditions: a) they are not bundled and b) they are entered into using GSA delegated authority. Such leases (1) have no significant P3 risk of loss, (2) are already subject to existing FASAB guidance, (3) have well defined FAR-based contractual processes and remedies in place to address risks associated with landlord-tenant relationships, (4) have contractually capped payments for termination liabilities, and (5) have termination payments that are indemnified by GSA's Building Fund. The Board believes that if a lease is either bundled or not entered into using GSA delegated authority, the provisions of this Statement should apply.

b. to not broadly exclude Enhanced Use Leases (EULs) except for those meeting the two conditions cited above because they are more oriented towards P3s as a result of (1) possessing special authorities and not being subject to the FAR, (2) often operating under a risk-reward model as opposed to those entity leases that are basically a landlord-tenant relationship and not a risk-sharing partnership, and (3) possibly including ancillary services and in-kind consideration as part of the arrangement or transaction. Because the Board believes that EULs could be encompassed by this Statement, a determination should be made as to whether disclosures are required via the application of the risk-based characteristics.

Risk-based Characteristics

A19. Although federal P3s are varied and complex, the Board believes there are some common characteristics that can be used to identify those P3s that create risk of loss and should be disclosed. Because the Board is aware of the administrative burdens agencies face day-to-day and that some P3 portfolios might be voluminous, in addition to identifying those P3s that create risk of loss, the risk-based characteristics can also be applied to assist a federal entity in determining which P3 arrangements or transactions do not require disclosure.

[18] The term leases includes enhanced use leases (EULs) which are typically long-term lease agreements that allow public or private entities to use an agency's property. Agency EUL programs have allowed entities to develop or occupy federal properties such as power plants, housing and healthcare facilities, office space, and parking facilities, and in return, federal agencies receive cash or in-kind consideration. Please note that there is no government-wide definition of EULs. Source: GAO-13-14 Federal Real Property: Improved Cost Reporting Would Help Decision Makers Weigh the Benefits of Enhanced Use Leasing, December 2012).

A20. The risk-based characteristics have been developed, refined, and categorized from an initial comprehensive list of characteristics that distinguishes federal P3s from traditional procurement actions. With the assistance of the task force, the Board further analyzed and then selected risk-based characteristics which indicate significant P3 risk of loss. These risk-based characteristics are intended to: (1) apply to all types of P3s: construction, housing, utilities, military depots, and others, and (2) assist a federal entity in ascertaining which P3 arrangements or transactions should be disclosed. Once a P3 is identified for disclosure, such arrangements or transactions would then be evaluated in light of the entity's materiality considerations including quantitative and qualitative threshold(s).

A21. As a result of respondent comments concerning linkage between the definition and the risk-based characteristics, the working group recommended and the Board adopted an additional risk-based characteristic for grants and other arrangements. Specifically, OMB requirements (2 C.F.R. Title 2, Part 200) for grants govern the administrative framework and include requirements to help safeguard and protect taxpayer dollars. Therefore, those P3s exempt from such requirements are at an increased-risk because well-established safeguards and resolution mechanisms are absent.

Conclusive and Suggestive Characteristics

A22. The majority of respondents agreed with the risk-based characteristics, their related classification, and their proposed application. However, as mentioned above, the working group recommended and the Board adopted an additional risk-based characteristic for grants and other arrangements. Moreover, the Board clarified the two categories of risk-based characteristics (conclusive and suggestive) pursuant to respondent concerns. Conclusive characteristics are those that existence of any one characteristic means the P3 arrangement or transaction should be disclosed. However, existence of any one of the suggestive characteristics is evidence that the P3 arrangement or transaction may possess risk of loss and require disclosure. Such a suggestive characteristic should be considered in the aggregate with all the other suggestive characteristics before a final decision is made. Each conclusive characteristic is meant to be definitive whereas each suggestive characteristic requires entity judgment as each one is analyzed in connection with the other suggestive characteristics.

A23. If a P3 arrangement or transaction is subject to disclosure, it should be further evaluated in light of materiality considerations that include both qualitative and quantitative assessments. Additionally, materiality should be applied cumulatively or in the aggregate by the entity.

Materiality

Considering User Needs

A24. As the standards-setting body for the federal government, the Board has stated that there are two fundamental values that provide the foundation for governmental accounting and financial reporting: "accountability" and its corollary, "decision usefulness." Concepts explain that "Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability." The Board believes that P3 disclosures are an essential element in establishing accountability.

A25. In applying the concept of materiality, the needs of the users of the annual financial report should be considered. Specific to P3s for example, users are interested in: (1) assessing the costs and related risks of entering into such long-term agreements; (2) assessing the efficiency and effectiveness of these risk-sharing agreements as well as the government's management of its assets and liabilities; and (3) determining how financial resources, budgetary or otherwise, have been obtained and used and whether their acquisition and use were in accordance with the entity's legal authorization. As a result, the Board believes that the P3 disclosures required by this Statement will help answer these questions while achieving the associated reporting objectives.

Qualitative and Quantitative Assessments Require Judgment

A26. In connection with concerns over the breadth and scope of the definition, some respondents suggested that the Board develop a clear and objective materiality standard that would limit the disclosure requirement to those transactions that present substantial financial risk to the government. The Board believes that refining the definition and adding additional exclusions best addresses respondent concerns in this regard. Respondents are reminded that "materiality" has not been formally defined in the accounting community; rather, it is a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The determination of whether an item is material:

a. requires the exercise of considerable judgment, based on consideration of specific facts and circumstances, and

b. depends on the degree to which omitting or misstating information about this 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.

A27. The Board believes that preparers and auditors are in the best position to exercise this judgment predicated on their direct knowledge of the specific facts and circumstances and user needs. Furthermore, the Board believes that specific guidance concerning materiality assessments would limit preparer and auditor considerations and are therefore inappropriate.

A28. The Board notes that while a P3 arrangement or transaction might not be considered material from a quantitative standpoint, it may be considered qualitatively material and subject to this Statement's disclosure requirements if the disclosures would influence or change the judgment of the financial statement user. Exclusive reliance on certain quantitative benchmarks or thresholds to assess materiality should be avoided.

Materiality Includes Probability Assessments

A29. Decisions whether to recognize or, in the case of this Statement, disclose a P3 arrangement or transaction may take into account considerations that include uncertainties. Uncertainties can be expressed as a measurement of an appropriate attribute (for example, historical cost, fair value, expected value, or some other attribute) which may include an assessment of the probability of future flows of economic benefits or services (emphasis added). Furthermore, uncertainties are often subjected to assessments of the materiality of the item, and the benefit versus the cost of recognition or, in this Statement's case, disclosure.

A30. Statement of Federal Financial Accounting Standards 5 (SFFAS 5), *Accounting for Liabilities of the Federal Government,* states that "probable" refers to that which

a. can reasonably be expected, or

b. 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.

A31. The Board notes that the concept of probability is imprecise and may be difficult to apply with respect to certain P3 activities such as economic stabilization payments, in addition to other matters that could arise during the life of the P3 arrangement or transaction. However, the "more likely than not" phrase in SFFAS 5 accommodates the assessment of the probability of those uncertainties often associated with P3s due to their long-term nature and project variability.

A32. Historically, some studies including work done by GAO suggest that, in practice, preparers and auditors in the private sector often interpret "probable" to mean a subjective assessment of probability considerably in excess of 50%. However, FASAB has defined "probable" as "more likely than not," that is, a subjective assessment of probability greater than 50% (51% or more).

Risks that are Deemed Remote

A33. Most of the respondents agreed with the Alternative View that stated (1) disclosure of remote contingencies is not limited to the terms of contractual arrangements, (2) the concept of "significant exposure" is not sufficiently clear to result in consistent disclosures, and (3) risks related to entity operations or performance (referred to in the Alternative View as business risks) would be included in the risk disclosure. As such, respondents were concerned that such additional disclosures could overwhelm or mislead users. The Board believes that it has addressed respondent concerns in this regard by refining the definition contained in the Exposure Draft, adding additional exclusions, eliminating references to "significant exposure," and in emphasizing at paragraph 24d that remote risks of loss should be limited to those that are included in the terms of the contractual P3 arrangements or transactions. The Board is of the opinion that remote risks can and should be reported where appropriate as explained below.

A34. SFFAS 5 provides that contingencies deemed remote (that is, the chance that a loss has been incurred is slight) are not recognized as a contingent liability or disclosed.[19] However, SFFAS 5 requires that 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.

A35. The Board believes that some risks of loss associated with P3s may be consistent with contingencies in SFFAS 5 that arise because of an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity, including the concepts of probable, reasonably possible, and remote. It is this uncertainty, or risk in other words, that prompts entities to seek private partners who can best manage and/or contain the effects of the uncertainty that could ultimately lead to a loss. In applying SFFAS 5 some contingencies may be identified for which the degree of uncertainty is so great that no reporting (that is, recognition or disclosure) is required by that Statement. However, the Board notes that (1) reporting such contingencies is not inconsistent with the provisions of SFFAS 5 and (2) as discussed above at paragraph A32, because FASAB has defined

[19]Per SFFAS 5, paragraph 38, a contingent liability should be recognized when all of these three conditions are met:

- A past event or exchange transaction has occurred (for example, a federal entity has breached a contract with a nonfederal entity).
- A future outflow or other sacrifice of resources is probable (for example, 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 likely to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (for example, the federal entity's management determines an estimated settlement amount).

"probable" as "more likely than not," the FASAB framework suggests that "reasonably possible" and "remote" risks be assessed for disclosure at the remaining (more narrow) band.

A36. Due to their very nature, P3s can also possess risks of loss that may be considered remote but material. For example, excluding contractual protections afforded the government by the Federal Acquisition Regulation (FAR) inherently increases the entity's risk as does a relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. The Board believes such P3 arrangements or transactions should be disclosed, subject to materiality, even though the risks of loss included in the terms of the contractual P3 arrangements or transactions may be deemed remote. The Board further notes that enterprise risk management frameworks often focus on remote risks because of the magnitude of any potential adverse effects that might arise. Therefore, consideration should be given to those risks that management does not expect to be likely, but represent a material risk of loss to the government if they were to occur. With this being said, the Board also notes that such remote risks may have a reasonably high materiality threshold balanced by whether the omission is such that it is probable that the judgment of a reasonable person would have been changed or influenced by the disclosure. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

Disclosure Requirements of P3s

A37. The task force conducted research and identified examples of disclosures surrounding P3s from a variety of international and national authoritative sources which address P3 information needs for different types of users. Additionally, the task force considered fact-finding meetings with public and private representatives regarding the types of information that diverse users believe are important. As a result, the task force overwhelmingly agreed with requiring disclosures concerning (1) why the government selects a P3 model to conduct business, (2) the solicitation and procurement processes used, (3) how the P3 is structured, (4) the expected benefits, and (5) the total amounts expected to be paid. Although it was noted that requiring a description of the solicitation and procurement processes is unusual in financial reporting, the task force reached that conclusion because P3s fall outside the routine way governments procure services and such disclosures reveal the potential risk that governments assume, which can ultimately lead to liability recognition.

A38. In analyzing the task force's recommendations the Board considered the federal financial reporting objectives. Of the four objectives outlined in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, the operating performance and budgetary integrity objectives are identified as being most important for P3 reporting. The Board agreed that P3 reporting is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. As such, the Board agreed with the majority of the task force's recommendations. However, requiring disclosure of an entity's solicitation and procurement processes falls outside the realm of financial reporting. Furthermore, the Board questioned the informational value of such a disclosure and concluded that its cost also exceeded potential benefits identified by the task force.

A39. P3s are a form of investment and they should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are being managed and (b) whether the government's financial position improved or deteriorated over the period of the P3. P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements. These complexities necessitate the establishment of disclosure principles as a first step to (1) developing uniform principles-based guidance, and (2) identifying potential gaps in existing guidance.

A40. Respondents were mixed regarding disclosures with some stating that the disclosures are onerous and burdensome and the others in agreement with the proposed disclosures or seeking additional disclosures. As a result of considering the overall financial reporting objectives, and in light of certain respondent comments regarding administrative burden, the Board decided to not require disclosure of amounts estimated to be received and paid during each of the succeeding five years. That is, only the amounts received and paid by the government during the reporting period(s) and the amounts estimated to be received and paid in aggregate over the expected life of the P3 need be reported. In determining the expected life of the P3 arrangement or transaction the entity's economic incentives (that is, its risks and/or rewards) should be considered.

A41. The Board offers two examples regarding the determination of a P3s expected life. First, consider an infrastructure arrangement containing a master ground lease of 50 years where in exchange for an up-front payment the entity out-leases (government-owned) land for the construction of an office building and at the same time enters into an occupancy lease which can be renewed for up to 75 years. The expected life of the P3 should be limited to 50 years given the fact that the entity's economic incentive at year 50 changes due to the master ground lease's expiration. That is, at such time the entity may decide to renew the master ground lease and renegotiate its occupancy lease or sell the land and not renew the occupancy lease. As a result, the amounts estimated to be received and paid in aggregate over the 50 years would be reported. Second, consider a spare parts sustainment program where an entity partners with an inventory logistics firm to handle the entire supply chain management function of a major weapons system expected to remain in service for the next 25 years. Although by statute the entity can only enter into a 5 year (for example, base year with 4 renewable options) contract, it has an economic incentive to maintain the relationship beyond 5 years. This is primarily due to the fact that the private partner is likely to incur a substantial investment to manage the supply chain and the investment will need to be recovered over time. As a result, the amounts estimated to be received and paid in aggregate over the 25 years would be reported.

Aggregation

A42. Due to the relative complexity and potential voluminous nature of P3s that an entity might be party to, the Statement permits entities to aggregate disclosures by providing broad and summarized information instead of unique or discrete arrangement or transaction detail. However, entities are permitted to disclose information related to individually significant P3 arrangements or transactions separately if entity management believes that such disclosure would better meet user needs.

A43. For example, disclosures of P3 arrangements or transactions could be aggregated by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, or other means. In this way users are presented with information that is comprehensive and material to an entity's financial statements without placing an undue burden on preparers to provide P3 specific or granular level information. Respondents generally supported the aggregation of information.

Reporting Period

A44. Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a material P3 arrangement/transaction

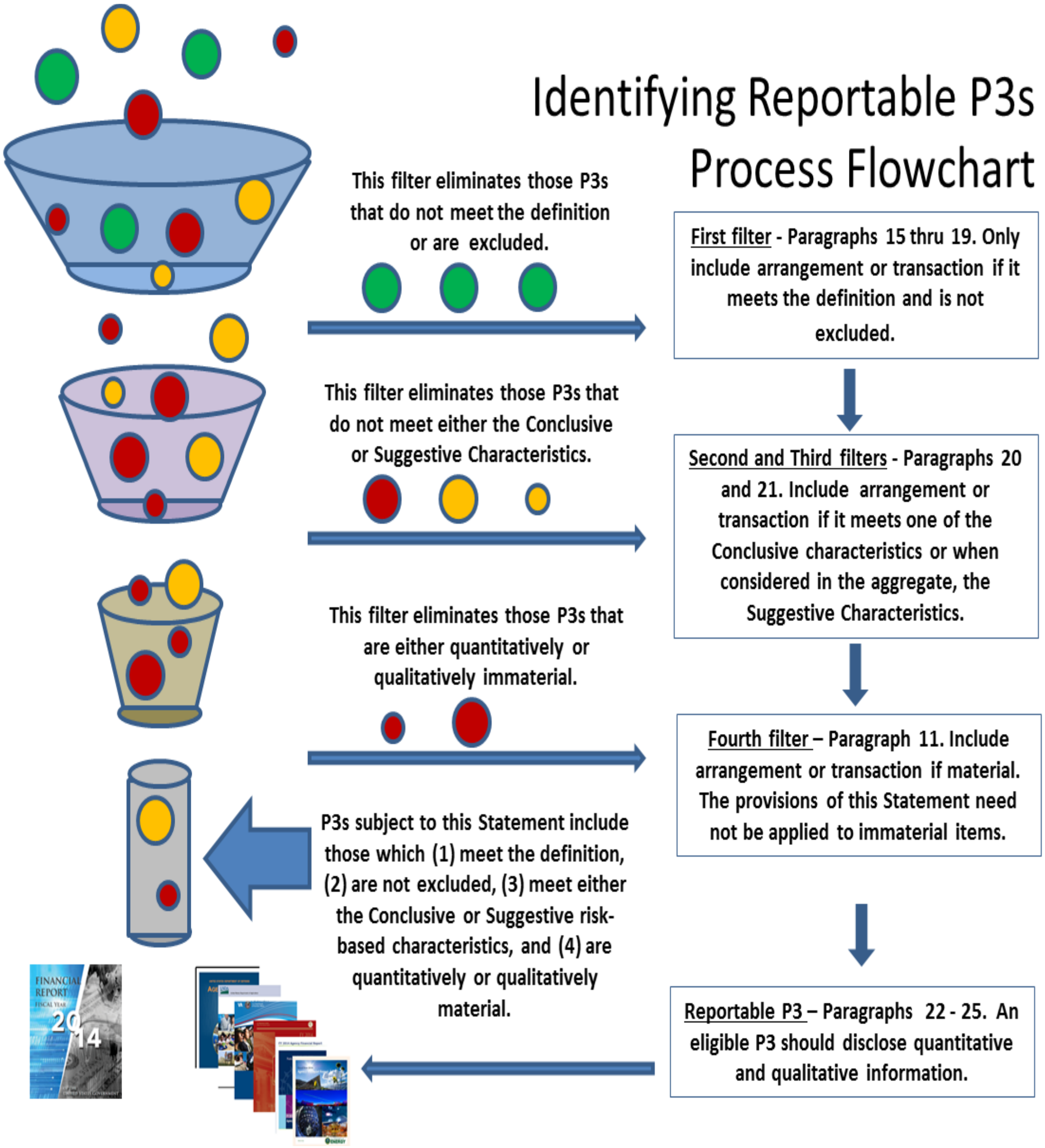
Board Approval and Dissent

A45. This Statement was approved for issuance by 8 members of the Board. One member dissented. The written ballots are available for public inspection at the FASAB's offices. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A46 and A47.

A46. Ms. Ho dissents to the issuance of this Statement. She believes that the increased use of P3s in the federal government makes the need for clarity in the accounting for P3s vitally important. Ms. Ho acknowledges that the taxpayer has the right to know what obligations the government has agreed to and what the total cost is for a P3 project. Ms. Ho commends FASAB for their thorough examination of the issue, which encompassed several years.

A47. Ms. Ho strongly supports more transparency in financial reporting of federal taxpayers' dollars. However, she shares the concerns voiced by many agencies in response to the exposure draft that the disclosures required by this Statement will create a burden that does not justify the cost required to collect, analyze, report and audit the information needed to comply with this Statement's requirements. In particular, Ms. Ho feels that the expected life requirement will result in inconsistent application by agencies throughout government, which is contrary to the goal of the Statement.

Appendix B: Flow Chart [20]



[20]The standards enunciated in this Statement and not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

APPENDIX C: ABBREVIATIONS

AGA	Association of Government Accountants
BFC	Basis for conclusions
CFR	Consolidated financial report of the U.S. government
C.F.R.	Code of federal regulations
CPA	Certified public accountant
ED	Exposure draft
EUL	Enhanced Use Lease
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPFFR	General purpose federal financial reports
GSA	General Services Administration
IRR	Internal rate of return
IT	Information Technology
LP	Limited Partnership
MD&A	Management's discussion and analysis
OMB	Office of Management and Budget
OPEB	Other postemployment benefits
P3	Public-Private Partnership

PP&E	Property, Plant, and Equipment
PPP	Public-Private Partnership
PSC	Public Sector Comparator
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SPV	Special Purpose Vehicle
U.S.	United States
VfM	Value for Money

Statement of Federal Financial Accounting Standard 50: Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, 10, and 23, and Rescinding SFFAS 35

Status

Issued	August 4, 2016
Effective Date	For periods beginning after September 30, 2016. Earlier implementation is encouraged.
Affects	• SFFAS 6, par. 25, 26, and 40. • SFFAS 10, par. 16 and 36. • SFFAS 23, amends par. 10 and rescinds par. 11-18. • SFFAS 35 is rescinded.
Affected by	None.
Related Guidance	TR18, *Implementation Guidance for Establishing Opening Balances*

Summary

This Statement provides implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment. It amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.* The alternative methods include (1) using deemed cost to establish opening balances of general property, plant, and equipment, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

The alternative methods are permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

Table Of Contents

Introduction

Purpose

1. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*: Amending Statements of Federal Financial Accounting Standards 6 and 23 by providing implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E).[1]

2. The alternative methods permitted by this Statement may be applied when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

3. This Statement provides implementation guidance to allow a reporting entity to apply an alternative valuation method (deemed cost) in establishing opening balances for general PP&E in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. It also allows an exclusion of land and land rights from the opening balances with disclosure of acreage information and expensing of future acquisitions. It also provides for selecting between deemed cost and prospective capitalization of internal use software (IUS) in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that was valued under an alternative method.

[1] For a complete discussion of the definition, characteristics, recognition, and measurement principles for general PP&E, see SFFAS 6, par. 21-39. For the definition, recognition, and measurement principles for internal use software, see SFFAS 10, par. 9-34.

4. As a result of these amendments and rescission, all implementation guidance for general PP&E, with the exception of specific provisions applicable to IUS, will be incorporated into SFFAS 6. The Board believes providing implementation guidance for general PP&E other than IUS in SFFAS 6 will provide a comprehensive guide for users in a single Statement.

Materiality

5. 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.

Standards

Scope

6. This Statement applies when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement. This Statement also is applicable to the financial report of the U. S. Government for purposes of consolidating a component reporting entity meeting the above conditions.

7. The alternative methods provided in this Statement may be applied in establishing **opening balances**[2] for the reporting period in which the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general property, plant, and equipment (PP&E) that were valued under an alternative method.

8. A reporting entity that meets either condition in paragraph 6 and elects to apply the alternative methods in establishing opening balances permitted by this Statement is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

[2] Terms defined in the Glossary are shown in bold-face the first time they appear.

Definitions

Definitions in paragraphs 9 – 10 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

9. **<u>Opening Balances—</u>**Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

10. **<u>Unreserved Assertion</u>—**An unreserved assertion is an unconditional statement.

Amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*

11. This paragraph amends SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 25 by adding the following language at the end of the first sentence: “unless the reporting entity made the election to implement the provisions of paragraph 40.g.i.”

    The revised paragraph 25 of SFFAS 6 is:

    25. Land and land rights acquired for or in connection with other general PP&E[29] shall be included in general PP&E <u>unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.</u>

12. This paragraph amends SFFAS 6, paragraph 26 by adding the following language as the second sentence: “Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein.”

[3] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

[29] "Acquired for or in connection with other general PP&E" is defined as 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.

The revised paragraph 26 of SFFAS 6 is:

26. All general PP&E shall be recorded at cost. <u>Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein.</u> Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include…

13. This paragraph amends the implementation guidance provided in SFFAS 6 by replacing paragraph 40.

Paragraph 40 of SFFAS 6 is replaced with:

40. Alternative Methods for Establishing Opening Balances.[44A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[44B] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

b. The application of these alternative methods based on the second condition specified in paragraph 40 is available to each reporting entity only once per line item.

[44A] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[44B] An unreserved assertion is an unconditional statement.

c. A reporting entity that meets either condition in paragraph 40 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources.*

d. Alternative Valuation Method. **Deemed cost**[44C] is an acceptable valuation method for opening balances of general PP&E. Because the reporting entity may have multiple component or subcomponent reporting entities[44D] using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[44E]

   i. **Replacement cost**[44F]

   ii. Estimated historical cost (initial amount). Reasonable estimates may be based on:

      a) cost of similar assets at the time of acquisition;
      b) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or
      c) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

[44C] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

[44D] SFFAS 47, *Reporting Entity*, provides that “component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

[44E] The methods are not listed in order of preference.

[44F] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life (Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46).

iii. **Fair value**[44G]

e. Establishing in-service dates.

   i. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.
   ii. It is not necessary to separately identify the in-service date for material improvements[44H] included in the opening balances of a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.

f. Alternative methods for land and land rights. A reporting entity should choose among the following alternative methods for establishing an opening balance for land and land rights. Because a reporting entity may have multiple component or subcomponent reporting entities selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

   i. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative method is applied, the reporting entity should expense future land and land right acquisitions.

   ii. Land and land rights may be recognized in opening balances based on the provisions of the alternative valuation method (deemed cost) provided in paragraph 40.d.

g. Once established using alternative methods, opening balances are considered consistent with GAAP.

h. Component Reporting Entity Disclosures:

[44G] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale (SFFAC 7, par. 38).

[44H] Material improvements are costs which either extend the useful life of existing general PP&E or enlarge or improve its capacity.

i. A component reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 40.f.i. to land and land rights should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures. In the event different alternative methods are applied to land and land rights (as permitted by paragraph 40.f.) by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

i. Financial Report of the U.S. Government Disclosures

i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

ii. When a component reporting entity elects to apply the provisions of paragraph 40.f.i. to land and land rights, the U. S. government-wide financial statements should disclose this fact, the number of acres held at the end of each reporting period, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report

Amendments to SFFAS 10, *Accounting for Internal Use Software*

14. This paragraph amends SFFAS 10, *Accounting for Internal Use Software*, paragraph 16 by adding the following first sentence: "Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein."

    The revised paragraph 16 of SFFAS 10 is:

    16. Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein. 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 costs incurred after…

15. This paragraph amends the implementation guidance provided in SFFAS 10 by replacing paragraph 36.

    Paragraph 36 of SFFAS 10 is replaced with:

    36. Alternative Methods for Establishing Opening Balances.[9A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or the line item addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

[6]For 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, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, pars. 94-95.

[9A]Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[9B] that its financial statements, or the line item addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

b. The application of these alternative methods based on the second condition specified in paragraph 36 is available only once to each reporting entity.

c. A reporting entity that meets either condition in paragraph 36 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7*, *Accounting for Revenue and Other Financing Sources.*

d. Alternative Methods. A reporting entity should choose among the following alternative methods for establishing an opening balance for internal use software. Because a reporting entity may have multiple component or subcomponent reporting entities[9C] selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

    i. Alternative Valuation Method. Deemed cost[9D] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40.d. for implementation guidance regarding deemed cost.

    ii. Prospective capitalization. The reporting entity may choose prospective capitalization of internal use software. If the reporting entity elects prospective

[9B]An unreserved assertion is an unconditional statement.

[9C] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

[9D]Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

treatment, the reporting entity should choose between the following acceptable alternative methods at the opening balance date:

a) Exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance.

b) Exclude internal use software in service from the opening balance, but include amounts related to internal use software under development at the opening balance date. Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 through 27 or on the alternative valuation method (deemed cost) provided in paragraph 36.d.i.

e. Once established using alternative methods, opening balances are considered consistent with GAAP.

f. Component Reporting Entity Disclosures:

i. A component reporting entity electing to apply deemed cost in establishing opening balances for internal use software should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 36.d.ii. should disclose this fact and describe the alternative methods used in the first reporting period in which the component reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternative methods are applied by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which the alternative method was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of internal use software included in the opening balance is required.

g. Financial Report of the U.S. Government Disclosures:

   i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

   ii. When a component reporting entity elects to apply the provisions of paragraph 36.d.ii., the U.S. government-wide financial statements should disclose this fact, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

Amendments to SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*

16. This section amends the implementation guidance provided in SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* as described in the following paragraphs.

17. Paragraph 10 is replaced with:

    10. See SFFAS 6 for implementation guidance applicable to all general PP&E.

18. Paragraphs 11-18 of SFFAS 23 are rescinded.

Rescission of SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*

19. This paragraph rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* in its entirety. Provisions from SFFAS 35 were incorporated into the implementation guidance of SFFAS 6 and SFFAS 10 as applicable.

Effective Date

20. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for FASAB's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, by providing the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is issued in response to DoD's request for guidance on establishing opening balances for general property, plant, and equipment (PP&E). Accounting for the federal government's general PP&E is complex and continues to be a challenge for large federal departments. This topic has been addressed in numerous Statements of Federal Financial Accounting Standards (SFFASs) and Interpretations as well as guidance issued by the Accounting and Auditing Policy Committee. SFFAS 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software*, SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* address the accounting and reporting requirements for general PP&E.

A3. During the project, the Board's staff met with DoD officials, as well as members of the audit community, to develop an understanding of the issues faced by DoD in establishing their baseline for general PP&E. This included discussing valuation methodologies employed, management assertions and the completion of audits, and the status of implementation of a system compliant with general accepted accounting principles (GAAP) for the DoD components.

A4. Based on the meetings and information provided it was determined that:

a. DoD's financial systems and many aspects of DoD's accounting policy for general PP&E have not been in accordance with GAAP.

b. Many DoD organizations that maintain several different accounting and property systems are involved in acquiring general PP&E assets.

c. DoD has not had consistent procedures related to general PP&E acquisitions or document retention.

d. All major systems DoD has utilized for acquisitions of general PP&E have either never been audited or, when audited, had significant deficiencies or material weaknesses.

e. Capital improvement projects have not been reliably tracked, so DoD was unable to determine the date the improvements were placed in service or to establish a valuation baseline.

f. DoD has approximately 440,000 separate real property assets, and many real property assets were built more than 40 years ago.

g. DoD records related to land values are not in a structured, searchable system. The records are not digitized and accessing them involves searching boxed records. Also, source documents, such as deeds, may not be complete, and court records often have gaps given the length of time involved.

h. DoD does not have a complete inventory of its internal use software (IUS), and costs of IUS have not been captured consistently.

i. General equipment is a broad category that includes military equipment and consists of hundreds of thousands of assets.

A5. After considering the status of DoD's efforts and the fact that DoD has had numerous years to implement the standards and has shown little progress, the Board discussed the merits of the project. Specifically, one member had concerns regarding the Board's role and potentially undermining the Board's own credibility by acting to offer relief to DoD (because the department has been unable to adopt GAAP requirements). The Board acknowledges that appearance is a concern. However, the Board has been tasked with establishing standards for which the benefits exceed the cost.

A6. The Board noted that while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when FASAB issued many of these standards, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of this Statement is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed), but for which the current use is limited to accountability and assessing the cost of current services. The Board proposed less costly alternatives that will support this objective.

A7. The Board believes assisting DoD with establishing a baseline benefits all parties. Providing a starting point will enable DoD to focus on needed improvements to systems and controls to process transactions going forward and thereby establish and maintain reliable financial information regarding future PP&E acquisitions. Establishing a sound financial management system is of primary importance.

A8. The Board also acknowledges that other standard-setters have provided guidance for organizations implementing an entire body of standards for the first time. The challenge of establishing opening balances for large public sector entities warrants the flexibilities provided in this Statement.

Summary of Outreach Efforts and Responses

A9. FASAB issued the exposure draft (ED) *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* on December 22, 2015, with comments requested by February 4, 2016.

A10. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News,* the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal, Government Executive,* the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A11. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations—Subcommittee on Defense
b. House Committee on Armed Services

c. House Committee on Oversight and Government Reform
d. House Committee on the Budget
e. House Committee on Veterans' Affairs
f. Senate Appropriations—Subcommittee on Defense
g. Senate Committee on Armed Services
h. Senate Committee on Finance
i. Senate Committee on Homeland Security and Governmental Affairs
j. Senate Committee on the Budget
k. Senate Committee on Veterans' Affairs

A12. FASAB received 22 responses from preparers, auditors, users of federal financial information, and professional associations. The majority of respondents agreed with the proposals to: (1) permit opening balances of general PP&E to be valued based on deemed cost and require the related disclosures, (2) allow a reporting entity to choose among alternative methods in establishing an opening balance for IUS and require the related disclosures, and (3) rescind SFFAS 35.

A13. However, approximately one-half of the respondents disagreed with the proposal to allow exclusion of land from the opening balances of general PP&E. They also disagreed with the proposal to require a reporting entity electing to exclude land from its general PP&E opening balances to exclude future land acquisition amounts.

A14. The respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A15. The Board did 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 considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

Land

A16. When developing the ED, the Board proposed options for land that were different from those for other general PP&E. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, focuses on relating costs to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance, both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in determining resource allocation. General PP&E is capitalized and depreciated to provide this information. Because land is not depreciated due to its infinite useful life, the benefits of capitalizing land are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and capitalized. In doing so, the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

A17. The Board carefully considered those aspects of the land category, along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board determined the most practical and cost-beneficial approach to establishing an opening balance for land would be to permit the reporting entity to exclude land from the opening balance of general PP&E and to support accountability through disclosures. The Board proposed that the reporting entity disclose, with a note reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land from its general PP&E opening balance would continue to exclude amounts for future land acquisitions. Accordingly, the reporting entity would provide the disclosures each year thereafter.

A18. Some members who supported excluding land expressed concern regarding the resulting inconsistency in reporting and suggested the Board begin a project on land in the near future to review existing standards, to explore options to improve reporting on land, and to seek a consistent approach. Other members wanted to explore valuing existing land holdings based on deemed cost (consistent with general PP&E) or on a set amount per acre of land. The Board asked respondents whether they agreed or disagreed with the proposal to allow exclusion of land from the opening balances of general PP&E even though other component reporting entities would report the cost of certain land in general PP&E. The Board also requested feedback regarding three alternative approaches: (1) to value general PP&E land holdings based on historical cost, a set amount per acre of land, deemed cost, or another valuation method, (2) to defer any changes in the current requirements until the Board completes a reexamination of the appropriate basis of accounting for land, or (3) to adopt another option.

A19. Approximately one-half of the respondents disagreed with the ED to allow exclusion of land from the opening balances of general PP&E. Nearly all respondents supported a land project to reexamine standards for reporting on land. In addition, the majority of the respondents preferred that the Board defer changes to the current land requirements, such as exclusions of land from the balance sheet or other actions that may affect future acquisitions, until the Board completes the re-examination.

A20. As part of due process, the Board carefully considered the following:

a. respondents’ comments regarding land,
b. DoD feedback regarding implementation challenges and options, and FASAB’s land

c. project plan entitled *Accounting and Reporting of Government Land*.

A21. Respondents' key reasons for disagreeing with the proposal to allow exclusion of land were (1) inconsistent accounting treatment that would be consolidated at the government-wide level and (2) the potential that a temporary change may lead to added cost for reporting entities electing to implement the Statement. Consistent with the support for permitting opening balances of general PP&E to be valued based on deemed cost, respondents agreed that deemed cost and/or existing standards could be used to value opening balances of land.

A22. The Board considered DoD's feedback because DoD would most likely elect to implement the Statement. DoD conveyed the following important factors to the Board:

a. DoD reports that it owns considerable land qualifying as general PP&E. DoD would have to expend significant financial and personnel resources to determine the valuation of land.
b. In contrast to the information used to establish deemed cost for other general PP&E, information that would be necessary to establish deemed cost for land would not be used for DoD management purposes.
c. DoD supports reporting acreage information until the land project is completed. The potential for future valuation requirements was not viewed as more costly than requiring deemed cost and later changing the valuation requirements. DoD noted there are current accountability requirements, and it is actively working on obtaining acreage information.

A23. Although respondents' conveyed that inconsistency was a concern, the Board notes that current standards are not consistent because they differentiate between stewardship land and land acquired in connection with development or construction of an item of general PP&E. Stewardship land is not capitalized, but disclosures of information regarding use of the land and physical measures are required (see SFFAS 29, *Heritage Assets and Stewardship Land*). Land classified as general PP&E is capitalized at historical cost. Stewardship land can be used in development or construction of general PP&E but is not capitalized.

A24. The land project is being initiated to address such inconsistencies, and Board members showed a strong commitment to moving forward and expediting the project to resolve inconsistencies. At the February 2016 Board meeting, the Board approved a project plan entitled *Accounting and Reporting of Government Land*. The requirements in SFFASs 6 and 29 have resulted in significant differences in accounting treatment for land holdings. The land project will consider additional research and factors to determine how best to account for and to report land. However, the Board does not believe decisions to be made in the land project should delay the exclusion of land from opening balances as provided in this Statement. This Statement is of limited scope and seeks cost beneficial options for opening balances. If the exclusion was not available, component reporting entities would be required to adopt one of the valuation methods available under deemed cost. The land project may reach conclusions that make such valuation methods obsolete, and the costs incurred to adopt deemed cost would have been unnecessary.

A25. Further, the Board has expressed a commitment to complete the land project quickly to resolve inconsistencies. The Board has also communicated to those parties most likely to be impacted that decisions made regarding land are subject to change as a result of the land project.

A26. As noted above, consistent with the support for opening balances of general PP&E to be valued based on deemed cost, respondents expressed that deemed cost could be used to value opening balances of land. Therefore, the Board believes deemed cost should also remain an option for establishing opening balances for land. As a result, a larger component reporting entity may establish an opening balance for land based on a combination of multiple subcomponent reporting entities' alternative methods, which may or may not be the same. This is permitted by the Statement. However, application of a particular alternative method must be consistent within each subcomponent reporting entity prior to its consolidation into a larger component reporting entity.

A27. One area that Board members believe needs transparency and additional clarification is the potential for inconsistent accounting treatment at the government-wide level, with some land reported in dollars and some in acres. The issue is further complicated by the fact that stewardship land is also included as a note reference on the balance sheet and reported in physical units, which may be different than acres. Without additional information to explain what is included at the consolidated level, this situation would not be clear to readers at the government-wide level. Therefore, the Board added a narrative disclosure requirement for the government-wide financial report. The disclosure requires a narrative explanation of any election made by component reporting entities regarding land. Each component reporting entity electing to exclude land should be identified with a reference to the component reporting entity's financial report.

A28. After considering all of the above factors, the Board considered the pros and cons of deferring significant action on land until the completion of the land project, as requested by the respondents who disagreed with the proposal. While the respondents are correct that land will be treated inconsistently, the Board believes it has a responsibility to weigh the cost of developing deemed cost for vast land holdings against the possibility that the land project will conclude that such deemed costs are not useful. Therefore, the Board adopted its proposal to permit land to be excluded from the opening balance of general PP&E and to support accountability through disclosures.

A29. Although some land rights[4] may not have an indefinite useful life, the Board proposed in the ED (similarly to what it did with respect to land) that an exclusion of land rights from the opening balances with disclosure of acreage information and expensing of future acquisitions. The Board recognizes that land rights are diverse, situation specific, and may not always result in disclosures required by this Statement. In fact, SFFAS 6 provides that land rights that are for a specified period of time shall be depreciated or amortized over that time period. The Board believes this is a cost effective approach for opening balances of land rights and completion of the land project would more fully research the issues and provide comprehensive standards. The Board reiterates that decisions made within this Statement regarding land and land rights are subject to change based upon the results of the land project.

A30. Although the majority of respondents agreed with the proposal to rescind SFFAS 35 and to permit reasonable estimates in the preparation of financial statements, this provision of the Statement generated many comments from respondents.

A31. A common suggestion provided by respondents was that reporting entities would benefit from the inclusion of language from paragraph 19[5] of the ED in SFFAS 6 and SFFAS 10 to clarify that the Board intended reasonable estimates to be applicable to any general PP&E versus just opening balances. Although the Board believes the broad statement provided in the paragraph should be sufficient to address the matter, members agreed including the provisions of paragraph 19 of the ED in SFFASs 6 and 10 may be clearer. Specifically, SFFAS 6, paragraph 26, and SFFAS 10, paragraph 16, were amended to specify that although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used.

A32. Respondents who disagreed with the proposal to rescind SFFAS 35 primarily cited audit concerns and the valuable guidance provided in SFFAS 35 as their reasoning. However, many of the detailed concerns expressed by respondents are addressed through existing guidance. The Board reiterates (as explained in the ED) that Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*, remains in effect regardless of these amendments and that each significant provision of SFFAS 35 was incorporated in the amendments—including the ability to use estimates in the future. In addition, SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* establishes a requirement for cost accounting that acknowledges the use of cost finding techniques and the allocation of costs on a reasonable and consistent basis.

[4] "Land 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, and other like interests in land.

[5] "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35."

The Board also believes it important to point out the Statement provides for the use of deemed cost to correct errors in the opening balances. Reporting entities should consider all available GAAP guidance when implementing new accounting standards.

Internal Use Software (IUS)

A33. While the majority of respondents agreed with the proposal to allow a reporting entity to choose among alternative methods in establishing an opening balance for IUS, several respondents expressed their concerns to the Board. Five respondents expressed concern with prospective capitalization of IUS, but agreed with deemed cost as an alternative method. The respondents did not believe component reporting entities should be able to adopt inconsistent alternative methods when establishing an opening balance for IUS. In contrast, one respondent believed prospective capitalization of IUS should be the only option because this would enhance consistency while also appropriately balancing the value and cost of the information in the financial statements.

A34. The Board recognizes the concerns raised by respondents and considered them during the development of the Statement. While the Board understands the importance of consistency and comparability in financial reporting, the Board believes users of federal financial statements often have different objectives and may not necessarily compare asset values among various reporting entities in the way that users of financial statements do in a commercial setting.

A35. The Board considered the fact that there may be component reporting entities (such as working capital funds that charge rates) for which the prospective treatment would be undesirable. The Board determined it would be best to provide optimum flexibility by providing for the option of deemed cost for IUS. Therefore, the Board agreed the Statement should allow for the alternative methods in establishing opening balances for IUS.

A36. The Statement requires the application of a particular alternative be consistent within each of the subcomponent reporting entities[6] prior to consolidation. In the event different alternative methods are applied by subcomponent reporting entities, the alternative method applied by each significant sub-component reporting entity should be disclosed. The Board believes the disclosure requirements regarding the different alternative

[6]SFFAS 47, *Reporting Entity*, provides that “component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

methods for establishing opening balances for IUS, if applicable, will support sufficient analysis for users of federal financial statements.

A37. The Board believes a reporting entity should be allowed to choose among alternative methods in establishing an opening balance for IUS. Concerns regarding inconsistencies will resolve quickly due to the short useful life of IUS.

Other Areas

A38. Certain respondents requested clarifying language be added to expand upon the phrase “one or more line items addressed by this Statement,” to define line items as being line items on the financial statements or line items within the note disclosures. The Board acknowledges the term line item is quite broad, especially in relation to general PP&E. The preparer can use judgment to decide upon the line items to present either on the face of a financial statement or in related disclosures. Therefore, the Board believes line items may be based on a class of general PP&E, such as those currently included in the required disclosures, or on other reasonable means of disaggregation on the face of the statement or in the notes.

A39. A respondent asked for clarification whether the standards apply to the government-wide reporting entity. It is the intention of the Board that all standards apply to any entity—component or government-wide unless otherwise stated. SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, states that SFFASs “apply to all federal entities, that is, to the Government as a whole and to component entities … unless provision is made for different accounting treatment in a current or subsequent SFFAS.” Because this Statement applies to first-time adopters as well as entities making an unreserved assertion for the first time, this Statement is applicable to the government-wide reporting entity for purposes of consolidating component reporting entities at any time.

A40. Several respondents provided comments regarding “in-service dates,” questioning whether the in-service dates for material improvements are the same as the base unit and if reporting entities should disregard the in-service dates for material improvements. The Board notes the Statement is permissive. Material improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service, but this treatment is not required.

Alternative Valuation Method and Implementation Guidance

A41. During deliberation on the project, the Board considered the recently-approved SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile*

Materials. SFFAS 48 permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. Deemed cost, or the amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances, was the alternative valuation method for valuation of opening balances (in accordance with SFFAS 3, *Accounting for Inventory and Related Property,* as amended by SFFAS 48).

A42. The Board based part of its decision to select deemed cost in SFFAS 48 on International Public Sector Accounting Standard (IPSAS) 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board reached several relevant conclusions in IPSAS 33:

a. Use of deemed cost facilitates the introduction of IPSASs in a cost-effective way.
b. Multiple options for deemed cost are appropriate.
c. The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.
d. Use of deemed cost does not affect fair presentation.

A43. Consistent with the decisions in SFFAS 48, the Board believes a similar approach is appropriate with this project. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for general PP&E. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 6, as amended, where historical records and systems do not support such balances.

A44. The Board determined permitting a reporting entity to apply alternative methods in establishing opening balances for general PP&E would be most appropriate through implementation guidance. The implementation guidance for general PP&E currently resides in several Statements. Accordingly, this Statement amends SFFAS 6, SFFAS 10, and SFFAS 23, and rescinds SFFAS 35 by providing implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general PP&E. Further, based on these amendments and rescission, all implementation guidance for general PP&E, with the exception of specific provisions applicable to IUS, will be in SFFAS 6. The Board believes providing implementation guidance for all general PP&E in SFFAS 6 will provide a more inclusive approach and a comprehensive guide for users versus reviewing multiple Statements that relate to this topic.

Amendments to Statements of Federal Financial Accounting Standards

Amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*

A45. This Statement amends SFFAS 6 implementation guidance to include alternative methods for establishing opening balances. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for general PP&E for the reporting period in which the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The presentation of line items may vary in detail. For example, components of general PP&E, such as land, may be a separate line item, or there may be a single line item for all general PP&E. Further, a reporting entity may determine it would like to make an unreserved assertion on classes of general PP&E disclosed in the notes to the financial statements.

A46. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 6, where historical records and systems do not support such balances. Accordingly, this Statement provides flexibility by permitting use of several measurement attributes and estimates. Deemed costs should be based on one, or a combination, of the following valuation methods: replacement cost, estimated historical cost, reasonable estimates, or fair value. The Board believes application of deemed cost is the most cost-effective option.

Plant Replacement Value (PRV)

A47. DoD currently estimates plant replacement value (PRV), which is based on cost factors such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. PRV is inclusive of capital improvements. While PRV has not been used for financial reporting purposes, DoD officials have stated it is used for decision making and management purposes. This Statement allows for PRV to be used as a starting point in establishing replacement cost for real property.

A48. SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 47, explains there may be several ways of arriving at an estimate of replacement cost:

> Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For

example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

A49. Although the PRV can be used as a starting point in establishing replacement cost for real property, adjustments would be needed. Further, the preparer would need to substantiate the PRV data used.

Government Property in the Hands of Contactors

A50. Government property in the hands of contactors has been a challenging area for reporting entities. This may include government-furnished equipment and contractor-acquired equipment. Previous Boards believed the accounting treatment for such assets should be consistent with that of other assets because there is no conceptual difference. Further, most would agree there should be accountability over government-owned assets in the hands of others.

A51. SFFAS 6, paragraph 18 provides that PP&E includes “property owned by the reporting entity in the hands of others (for example, state and local governments, colleges and universities, or Federal contractors)” and paragraph 34 (along with the footnote to paragraph 34) elaborates that PP&E should be recognized when title passes or is delivered to the acquiring entity or to an agent of the entity. For PP&E acquired by a contractor on behalf of the entity (for example, the entity will ultimately hold title to the PP&E), PP&E should also be recognized upon delivery, or constructive delivery, whether to the contractor for use in performing contract services or to the entity.

A52. During the due process deliberation of SFFAS 23 in 2003, this issue also surfaced. A respondent, unaware of existing standards, encouraged the Board to develop standards that address this type of property because the respondent believed that “accounting control over this property is deplorable.” As discussed in the Basis for Conclusions to SFFAS 23, the previous Board found 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.”

A53. The Board understands that certain reporting entities may have long-standing contracts lacking the contractual terms and systems needed to accumulate the necessary information. The alternative valuation method—deemed cost—is applicable to general PP&E in the hands of others. The Board considered other alternatives, including those proposed by DoD, to mitigate the cost of properly reporting such PP&E. DoD's proposal intended to take a prospective approach for establishing completeness and accountability for government property in the hands of contactors. Much of DoD's rationale was based on the belief that government property in the hands of contactors is immaterial and that the equipment has a short useful life. However, existing data have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. DoD also based the proposal on the fact that they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. DoD has other accountability obligations and a management need for complete records to support decision making.[7]

A54. The Board concluded that the current DoD process of including improved contract clauses in new or modified contracts should continue. As existing contracts expire or are modified, this issue should be resolved. Based on preliminary estimated information presented by DoD, 77% of the current contracts expire in 2016 and 12% expire in 2017. Hence, assuming that these estimates are reasonably accurate, processes would be in place to capture government property in the hands of contactors by 2018 through issuance of new contracts with required clauses. Considering that much of the information and data indicates the contracts for government property in the hands of contactors will expire soon and the assets may be immaterial or fully depreciated, with time, DoD may be in a position to support that this line item is not materially misstated. This supports that accounting treatment for government property in the hands of contactors should continue to be consistent with general PP&E.

A55. The Board conducted outreach on this topic prior to issuing the ED. Feedback from the audit community conveyed that the issues DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to DoD's proposal, there were noted audit challenges due to gray areas, such as no established cut-off date, the need for clarity with definitions, and complexities with implementation. In addition, there were noted existence and completeness challenges. There was also a belief that challenges will remain until the necessary contractual improvements are fully implemented.

Combination of Methods Permitted

[7]In a May 13, 2014, statement to the U. S. Senate Committee on Homeland Security and Governmental Affairs, then DoD Comptroller Robert Hale acknowledged the importance of completeness when he explained, "Our audit strategy focuses first on the elements of our business that most often influence our decision making—namely budgetary dollars and the existence and completeness of property records."

A56. The Board recognizes that large and complex reporting entities, such as DoD, may have used a variety of valuation methods prior to the adoption of a GAAP-compliant method. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6 at different times prior to establishing opening balances. Deemed cost should be based on one, or a combination, of the accepted valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

A57. The purpose of this Statement is to provide alternative methods for reporting entities meeting the scope conditions set forth in paragraph 6 of this Statement. Absent a reliable record of transactions related to hundreds of thousands of records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities, such as DoD, finalize a sound GAAP-compliant financial management system. All activity after the opening balances for general PP&E are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

Amendments to SFFAS 10, *Accounting for Internal Use Software*

A58. SFFAS 10 provides accounting standards for IUS used by federal entities. Previously, IUS had been addressed in SFFAS 6. Because certain questions remained, the Board decided to review the issues and to develop a separate Statement.

A59. IUS addressed by SFFAS 10 includes purchased commercial “off-the-shelf” software, contractor-developed software, and internally-developed software. Under the provisions of SFFAS 10, IUS is classified as general PP&E as defined in SFFAS 6. With the issuance of SFFAS 10, the section on IUS in SFFAS 6 was rescinded. SFFAS 10 provided guidance regarding the definition of IUS, the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, as well as other guidance.

A60. When SFFAS 10 was issued, the previous Board in effect provided for prospective implementation of SFFAS 10 in paragraph 36 by stating that “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.”

A61. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains that some entities have not had or do not have systems that can provide the information necessary; therefore, the conditions remain that existed when many of these standards were issued. The Board considered certain unique aspects to this category of general PP&E that justify a similar treatment that was provided when SFFAS 10 was established. Specifically, the Board believes it would be cost-beneficial to allow prospective treatment of IUS because it typically has a shorter useful life than other assets and is a soft asset that is harder to inventory when compared to tangible assets. These facts make the cost of implementation higher than for other general PP&E and the benefit lower due to the shorter time the IUS would be reported as an asset for amortization.

A62. Therefore, the Board believes the most appropriate path is to amend the implementation guidance provided in SFFAS 10 to provide for prospective application of IUS if the reporting entity elects to do so. Considering the various stages of implementation within reporting entities, the Board determined this Statement should provide flexibility. Therefore, the guidance also provides for an alternative valuation method consistent with general PP&E. Considering IUS is classified as general PP&E, the Board believes it is appropriate to allow use of deemed cost and to refer users to the deemed cost implementation guidance in SFFAS 6. Together, these amendments allow the preparer to elect:

a. to establish opening balances for existing IUS based on deemed cost,

b. to establish an opening balance of zero and to capitalize costs consistent with SFFAS 10 prospectively, or to

c. establish an opening balance of zero for IUS in service, and to establish an opening balance for IUS in development based on deemed cost, and to capitalize costs consistent with SFFAS 10 prospectively.

A63. Based on the flexibility offered for establishing opening balances for IUS, a larger reporting entity may establish an opening balance for IUS based on a combination of multiple component reporting entities' alternative methods, which may or may not be the same. Therefore, a larger reporting entity may have multiple component reporting entities[8] that selected different alternative methods. This is permitted by the Statement; a larger reporting entity may establish an opening balance based on a combination of alternative methods. Application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger reporting entity.

[8]SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Amendments to SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*

A64. The purpose of SFFAS 23 was to amend specific standards with regard to national defense (ND) PP&E. More specifically, SFFAS 23 rescinded the term "ND PP&E."

A65. SFFAS 23 also provided implementation guidance for assets reclassified as general PP&E. Much of that guidance referred to the requirements in the implementation guidance provided in SFFAS 6. SFFAS 23 was effective for periods beginning after September 30, 2002, with earlier implementation encouraged. The Board believes it appropriate to rescind the implementation guidance in SFFAS 23 and to refer users to the implementation guidance in SFFAS 6 that applies to all general PP&E, including general PP&E assets previously considered ND PP&E.

A66. By rescinding the paragraphs in SFFAS 23, the Board ensured the appropriate relevant guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board chose not to rescind SFFAS 23 in its entirety because the standards provide other amendments, such as rescinding the term ND PP&E as discussed above, which must be maintained.

Rescission of SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*

A67. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data's historical cost may be used to value general PP&E. It was to establish a cost-effective method to comply with SFFAS 6 by allowing reasonable estimates determined in accordance with SFFAS 6, as amended. While rescinding SFFAS 35 in its entirety, the Board ensured any pertinent guidance was included in the amendments to the SFFAS 6 implementation guidance.

A68. The Board also reiterates the conclusions of the previous Board. As explained in SFFAS 35, Basis for Conclusions, paragraph A12:

> The Board stresses to federal entities that the measurement basis for G-PP&E remains historical cost; however, reasonable estimates are allowed. The Board believes entities should use judgment regarding the decision to use estimated historical cost in lieu of original transaction based data. The Board also notes that estimates are widely used throughout the financial statements. In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.

A69. When SFFAS 35 was issued, the Board believed that allowing or encouraging estimates as reporting entities worked towards implementing systems and processes that could capture historical data would be beneficial. However, it appears this has not occurred at all departments, and there has been an overreliance that was unintended. The language in SFFAS 35 has often been misinterpreted to mean something other than reasonable estimates is in accordance with SFFAS 6.

A70. Therefore, the Board believes it is appropriate to rescind SFFAS 35. The Board acknowledges that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35. As noted in paragraph A17 of SFFAS 35, “estimates that do not lead to material misstatements are acceptable without guidance from the Board.”

A71. Prior to the issuance of the ED, DoD raised concerns with the Board’s proposal to rescind SFFAS 35 based on the time it would take for DoD to become full cost compliant. DoD requested the Board consider retaining SFFAS 35 or providing transitional guidance in this area. The Board believes current standards provide flexibility and there are resources other than SFFAS 35 within the GAAP hierarchy to assist in this area. For example, there is guidance (Technical Releases) to assist in accumulating, allocating, and reporting the cost of general PP&E when there is no detailed cost accounting system.

A72. Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the general PP&E lifecycle, as well as decisions regarding the granularity of cost information and acceptable methods for recognizing those costs. This implementation guidance is not dependent on SFFAS 35 and remains applicable even if SFFAS 35 is rescinded.

A73. Additionally, SFFAS 4 established a requirement for cost accounting that acknowledges the use of cost finding techniques. The requirement is:

> Each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

A74. Management has discretion in applying the cost assignment methods identified in SFFAS 4, *Managerial Cost Accounting Standards and Concepts* to accumulate acquisition costs. Of particular importance is the emphasis on economic feasibility with regard to direct tracing of costs to outputs. SFFAS 4, paragraph 124, provides that "[in] principle, costs should be assigned to outputs in one of the methods listed below 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."

Disclosures

A75. The disclosures required for component reporting entities and the government-wide reporting entity are also included in the amendments to the implementation guidance in SFFAS 6 and 10. Specifically, the election to apply the provisions of this Statement should be disclosed in the financial statements in the first reporting period in which the component reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The first reporting period would be the first year-end financial statement that an unreserved assertion is made. The Board does not believe the first reporting period should be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures.

A76. The Board notes that the term “unreserved assertion” may be used in other contexts. For example, certain entities’ management (such as DoD) may be required to make management assertions regarding their financial information and that their financial statements are validated as ready for audit by no later than September 30, 2017. This Statement refers to an unreserved assertion that the reporting entity’s “financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.” Other assertions—such as being ready for an audit—may or may not accompany such an assertion.

A77. The component reporting entity disclosures (in the amendments to SFFAS 6) address both component reporting entities that may have elected to only apply deemed cost in establishing the opening balances for general PP&E as well as component reporting entities that elected to apply the provision to exclude land and land rights from opening balances. For those component reporting entities only applying deemed cost, the component reporting entity should disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required. This disclosure need not be repeated unless the financial statements or, as applicable, reports on line items are presented for comparative purposes.

A78. A component reporting entity electing to exclude land and land rights should disclose this fact and describe the alternative method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP and continue to be so as long as an amount is not reported on the balance sheet. In addition, those reporting entities electing to exclude land and land rights from its general PP&E opening balances must also disclose, with a note reference on the balance sheet, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. The Board believes requiring these disclosures would meet accountability requirements and ensure appropriate measures continue to be taken for existence and completeness requirements. As discussed above, the Board determined that a larger component reporting entity may establish an opening balance for land and land rights based on a combination of multiple subcomponent reporting entities' alternative methods, which may or may not be the same. However, application of a particular alternative method must be consistent within each subcomponent reporting entity prior to its consolidation into a larger component reporting entity.

A79. The component reporting entity disclosures (in the amendments to SFFAS 10) address that component reporting entities may have elected to apply different alternative methods in establishing the opening balance of internal use software. This Statement provides for an alternative valuation method of deemed cost that is consistent with general PP&E and prospective capitalization of IUS. A component reporting entity electing to apply the alternative methods should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternative methods are applied by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

A80. Further, the government-wide reporting entity should disclose when a component reporting entity elects to apply deemed cost along with a reference to the component reporting entity's financial report. In addition, when a component reporting entity elects to exclude land and land rights, this also should be disclosed, along with an explanation of the election, the number of acres with a reference to the component reporting entity's financial report. The government-wide reporting entity should disclose when a component reporting entity elects to apply deemed cost in establishing opening balances for internal use software. In addition, when a component reporting entity elects to apply prospective capitalization, an explanation of the election and reference to the component reporting entity's financial report should be disclosed.

Application of this Statement

A81. A component reporting entity in the process of implementing systems that are GAAP-compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A82. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP-compliant systems; this allows them to assert independently of the larger DoD. It is anticipated DoD will make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be the DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements, or one or more line items, addressed by this Statement.

A83. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election because it may only be made once. A complex entity should work with its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities should ensure issues, such as supporting documentation for opening balances, are addressed and validated through sampling or other means, including consideration of any audit findings or conclusion affecting the reliability of the valuation, prior to making the unreserved assertion. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation in all material respects. If the audit for fiscal year 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to continue in subsequent years to correct or to support the valuation as of the beginning of fiscal year 2018.

A84. Reporting entities that meet the conditions specified in paragraph 6 and elect to apply the alternative methods in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Specifically, paragraph 12 of SFFAS 21 states, "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards."

A85. Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13.a. – 13.c. for all changes in accounting principles:

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.
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.

A86. SFFAS 21 provides that 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. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and explain that opening balances of a particular line item or group of line items were valued at deemed cost under this Statement, then briefly describe deemed cost and indicate the effect of adoption on beginning net position.

A87. In addition, the alternative methods provided in this Statement should also be applied in correcting subsequently discovered errors in general PP&E that was valued under an alternative method.

Board Approval

A88. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB’s offices.

Appendix B: Abbreviations

DoD	Department of Defense
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IUS	Internal Use Software
ND	National Defense
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
PRV	Plant Replacement Value
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 51: Insurance Programs

Status

Issued	January 18, 2017
Effective Date	For periods beginning after September 30, 2018.
Affects	• SFFAS 5, rescinds par. 97-121.
Affected by	None.

Summary

This Statement establishes accounting and financial reporting standards for insurance programs. It provides standards to ensure that insurance programs are adequately defined and report consistent information about the liabilities for losses incurred and claimed as well as expected losses during remaining coverage. These standards replace the insurance and guarantee program standards provided in paragraphs 97-121 of Statement of Federal Financial Accounting Standards 5, *Accounting for Liabilities of The Federal Government*.

To support consistency, this Statement identifies three categories: 1) exchange transaction insurance programs other than life insurance, 2) nonexchange transaction insurance programs, and 3) life insurance programs. Insurance programs are categorized based upon the type of revenue received as defined by Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

This Statement provides guidance as to how and when insurance programs should recognize revenue, expenses, and liabilities according to the aforementioned categories. The recognition, measurement, and disclosure guidance provides for concise, meaningful, and transparent information regarding the operating performance of insurance programs.

Insurance Programs is the first phase in a multiple phase project entitled *Risk Assumed.* Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.

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.

Table Of Contents

Standards

Scope

1. This Statement applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement provides general principles that should guide preparers of GPFFRs in accounting for and reporting on exchange and nonexchange insurance transactions, related claims and liabilities, losses, and costs of insurance programs. Other items related to insurance program activities such as revenue classification that are not addressed in this Statement should be reported in accordance with other standards.

3. This Statement rescinds the Insurance and Guarantees section in SFFAS 5, *Accounting for Liabilities of The Federal Government, paragraphs 97-121*.

4. This Statement establishes three categories of insurance and related guidance: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs. In addition, there is a section providing government-wide disclosure requirements.

Definitions

Definitions in paragraphs 5 through 21 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

5. **Insurance Program-**"insurance program" is a general term used to refer to a program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

6. The following are excluded from insurance programs:

    a. Programs that administer direct loans and loan guarantees[1]

    b. Programs that qualify as social insurance[2]

    c. Programs authorized to engage in disaster relief activities[3]

    d. Programs that provide grants

    e. Programs that provide benefits or assistance based on an individual's or a household's income and/or assets

    f. Programs that assume the risk of loss arising from federal government operations[4]

    g. Programs that pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency[5]

[1] SFFAS 2, *Accounting for Direct Loans and Loan Guarantees.*

[2] SFFAS 17, *Accounting for Social Insurance* (including unemployment insurance).

[3] The Robert T. Stafford Disaster Relief and Emergency Assistance Act (Public Law 100-707), commonly referred to as the Stafford Act, is the act that authorizes and regulates disaster relief programs.

[4] For example, see Government Accountability Office (GAO)-05-265R, *Catalogue of Federal Insurance Activities, Enclosure IV: Description of Accounts With Federal Self-Insurance Activity*

[5] An example may include an administrative settlement or tort claim resulting from military events.

h. Programs that indemnify contractors, agreement partners, and other third parties for loss or damage incurred while or caused by work performed for a federal agency[6]

i. Workers' or occupational illness compensation programs that compensate current or former employees (or survivors) and certain third parties for injuries and occupational diseases obtained while working for a federal agency

7. **Adverse Event**—an "adverse event" may be a single-occurring event or a series of events that cause losses to the beneficiary or beneficiaries as identified in the insurance arrangement.

8. **Cash Surrender Value**—the "cash surrender value" is the sum of money that will be returned to the policyholder on a life insurance policy if the policy is canceled before its maturity or the insured event (death) occurs.

9. **Claim Adjustment Expenses (CAE)**—"claim adjustment expenses" (CAE) are incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

10. **Arrangement Period**—"arrangement period" is the period over which adverse events that occur are covered.

11. **Exchange Transaction Insurance Programs Other Than Life Insurance**—"exchange transaction insurance programs other than life insurance" cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions with the federal government as defined in SFFAS 7.[7]

12. **In-Force**—"in-force" refers to arrangements that are unexpired as of a given date.

13. **Incurred But Not Reported (IBNR)**—claims "incurred but not reported" (IBNR) are estimated claims from events that have occurred as of the end of the reporting period but have not yet been reported for settlement.

[6] These are administrative settlements for transactions with contractors under the Federal Acquisition Regulation's authorized indemnification clauses, as well as authorized indemnification clauses within other legally binding arrangements. First responders within programs that do not have a statutory insurance or guarantee mission are also within this scope.

[7] SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

14. **Insurance Claim**—an "insurance claim" is a formal request for payment for losses as authorized under the insurance arrangement.

15. **Insurance Arrangement (Arrangement)**—an “insurance arrangement” (arrangement) is a general term used for a contract or other agreement between an insurance program and specific parties, such as but not limited to individuals, state, local, or foreign governments, other federal agencies, or businesses. An arrangement may include and/or identify:

    a. the term the insurance arrangement is in-force,

    b. the insurance program’s responsibilities,

    c. the risk assumed by the insurance program, such as:

        i. all risk for covered losses,

        ii. partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance,

        iii. a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid, or

        iv. risks shared with a third party.

    d. the adverse event,

    e. the insured party or parties and their premium requirements,

    f. the beneficiary or beneficiaries and their responsibilities for filing claims, and/or

    g. the financial compensation.

16. **Insurance Portfolio**—an “insurance portfolio” is a grouping of insurance programs or arrangements that have some meaningful relationship based on arrangement period/duration, shared risks, management, customers, geographic regions, or other factors.

17. **Liability for Losses on Remaining Coverage**—the “liability for losses on remaining coverage” is an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open arrangement period.

18. **Life Insurance Programs**—"life insurance programs" cover the risk of loss from death of individuals.

19. **Nonexchange Transaction Insurance Programs**—"nonexchange transaction insurance programs" cover the risk of loss from adverse events through nonexchange transactions, as defined in SFFAS 7.

20. **Premiums**— "premiums" is a general term used to refer to exchange revenue [8] billed by insurance programs. Programs may refer to their exchange revenue by various terms, including but not limited to premiums, assessments, and/or fees.

21. **Recoveries**—"recoveries" include monies:

    a. returned from another agency through an indemnification agreement,

    b. returned from a third party or commercial insurance company to repay all or part of a loss originally paid for by the program,

    c. recouped from the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or

    d. received from adjustments made to previously paid insurance claims.

Exchange Transaction Insurance Programs Other Than Life Insurance

22. Exchange transaction insurance programs other than life insurance collect premiums through arrangements to cover the risk of loss from adverse events other than death of individuals.

23. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

[8] See SFFAS 7, par. 33, for the exchange revenue definition and Appendix B: Guidance for the Classification of Transactions, par. 284, for the classification of exchange revenue insurance programs.

Recognition and Measurement

Revenue and Liability for Unearned Premiums

24. Premiums should be recognized as revenue when earned over the period of the arrangement in proportion to insurance protection provided.

25. A liability for unearned premiums should be recognized for the amount of premiums collected and/or due by the end of the reporting period that have not yet been earned in proportion to the insurance protection to be provided during the remaining arrangement period.

Liability for Unpaid Insurance Claims

26. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

27. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid

        ii. claims incurred but not reported (IBNR)

            (1.) A single-occurring event or a series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[9]

            (2.) Management should use judgment to determine if an adverse event causes claims IBNR prior to the reporting date.

    b. related estimated CAE, and

    c. estimated inflows from recoveries not realized at the end of the reporting period.

[9] If a series of events causing loss begins prior to the reporting date and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for claims IBNR.

i. If estimated recoveries exceed the related claims for an insurance portfolio then recognition is limited to the amount of the related claims.[10]

ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

28. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

29. Guidance from SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards,* applies to subsequent events relating to unpaid insurance claims.

Liability for Losses on Remaining Coverage

30. The liability for losses on remaining coverage as of the end of the reporting period represents the estimated amounts to be paid to settle claims (including CAE) for the remaining open arrangement period in excess of the sum of both:

    a. related unearned premiums as of the end of the reporting period and

    b. premiums due after the end of the reporting period that relate to the remaining open arrangement period.

31. Estimates should be determined by considering insurance portfolios rather than individual arrangements.

32. The liability should be estimated using methods designed to address uncertainties concerning future events.

33. The objective of such methods is a reasonable estimate of expected cash flow. While there are various ways to determine expected cash flow, methods using Actuarial Standards of Practice[11] are generally appropriate.

34. No specific method is required. An entity must use judgment based on the risk inherent in the insurance portfolio, sensitivity to external factors, and the availability of relevant

[10]Any amount expected to be recovered in excess of the recognized claim, which will result in a gain, should not be recognized until any contingencies relating to the recovery have been resolved because a contingent gain cannot be recognized until realized.

[11]See http://www.actuarialstandardsboard.org/standards-of-practice/ (last accessed October 18, 2016).

information to select a method. A reporting entity should consider all relevant information at the balance sheet date. This information may include:

a. historical experience;

b. adjustments to historical experience for differences in current conditions;

c. current conditions;

d. trends;

e. assumptions about future events;

f. risk factors;

g. uncertainties about possible variations in the amount or timing of the potential settlement of claims; and

h. as appropriate, data, projections, and supporting analysis supplied by independent expert(s).

35. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to losses on remaining coverage should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.

36. If the effect of the time value of money is significant, for example, when settlement may occur over several years, then the estimated settlement amount should be discounted. (See SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates,* par. 28-32 for guidance on selecting discount rates.)

37. Adjustments to the liability for losses on remaining coverage should be recognized as a component of claims expense.

Disclosure Requirements

Factors in Determining Disclosures

38. Materiality is an overarching consideration in financial reporting for information that should be presented regarding exchange transaction insurance programs other than life insurance. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating

large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

39. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR, such as the Debt Note to the Financial Statements.

Disclosures Applicable to Component Entity Reports

40. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program

    b. Full costs,[12] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

    c. Investing activities, such as buying treasury securities

    d. Arrangement duration and renewal characteristics, such as non-cancelable or guaranteed renewals

    e. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums and any requirements to set premium prices that do not cover the full estimated cost to settle claims

    f. The nature and magnitude of uncertainty of estimated amounts to be paid to settle future claims, including:

        i. the basis and estimation method

        ii. significant risk assumptions and factors, including relevant trend information

        iii. how much risk, if any, is shared by third parties

[12] See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

g. The total amount of coverage provided through insurance in-force as of the end of the reporting period[13]

h. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

41. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

a. Beginning balance

b. Claims expense

c. CAE[14]

d. Payments to settle claims

e. Recoveries and other adjustments

f. Ending balance

Nonexchange Transaction Insurance Programs

42. Nonexchange insurance programs collect funds on demand and/or receive appropriations to cover the risk of loss from certain adverse events.

43. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

[13] An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

[14] Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

Recognition and Measurement

Revenue

44. Nonexchange transaction insurance programs should apply general revenue recognition standards as found in SFFAS 7 (as amended).

Liability for Unpaid Insurance Claims

45. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

46. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid

        ii. claims IBNR

            (1.) A series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[15]

            (2.) Management should use judgment to determine if an adverse event causes claims IBNR prior to the reporting date.

    b. related estimated CAE, and

    c. estimated inflows from recoveries not realized at the end of the reporting period.

        i. If estimated recoveries exceed the related claims for a specific portfolio then recognition is limited to the amount of the related claims.[16]

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[15]If a series of events causing loss begins prior to the reporting date and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for claims IBNR.

[16]Any amount expected to be recovered in excess of the recognized claim which will result in a gain should not be recognized until any contingencies relating to the recovery have been resolved; a contingent gain cannot be recognized until realized.

ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

47. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

48. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

Disclosure Requirements

Factors in Determining Disclosures

49. Materiality is an overarching consideration in financial reporting for information that should be presented regarding nonexchange transaction insurance programs. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

50. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

51. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program

    b. Full costs,[17] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

    c. Investing activities, such as buying treasury securities

[17] See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, paragraphs 80 -104.

d. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

52. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

    b. Claims expenses

    c. CAE[18]

    d. Payments to settle claims

    e. Recoveries and other adjustments

    f. Ending balance

Life Insurance Programs

53. Life insurance programs collect premiums for life insurance arrangements to cover the risk of loss from death of individuals.

Recognition and Measurement

Revenue

54. Premiums should be recognized as revenue when due from policyholders.

Liability for Unpaid Insurance Claims

55. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

56. The estimated settlement amount includes:

[18]Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

a. outflows to liquidate:

    i. claims that have been reported but not paid

    ii. claims IBNR

b. related estimated CAE, and

c. estimated inflows from recoveries, such as monies recovered from improper payments, not realized at the end of the reporting period.

    i. If estimated recoveries exceed the related claims for a group of arrangements then recognition is limited to the amount of the related claims.[19]

    ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

57. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

58. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

Liability for Future Policy Benefits

59. The liability for future policy benefits represents the expected present value of future claims to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders.

60. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to the liability for future policy benefits should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.

61. Estimates should be determined by considering insurance portfolios rather than individual arrangements.

[19] Any amount expected to be recovered in excess of the recognized claim which will result in a gain should not be recognized until any contingencies relating to the recovery have been resolved; a contingent gain cannot be recognized until realized.

62. The liability is estimated using appropriate financial and/or actuarial methods that include assumptions, such as estimates of expected investment yield, mortality, morbidity, terminations, and expenses. (For more information, see SFFAS 33.)

63. Changes in the liability for future policy benefits that result from periodic re-estimations should be recognized as an expense during the period in which the changes occur.

64. The effects of changes in relevant law or policy should be recognized when those changes occur.

Disclosure Requirements

Factors in Determining Disclosures

65. Materiality is an overarching consideration in financial reporting for information that should be presented regarding life insurance programs. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

66. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

67. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. The type of life insurance and specific characteristics of those products, such as when and how benefits are paid and what other government agencies or commercial insurance programs administer and/or assume risk for any part of the program

    b. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums and requirements to set premium prices that do not cover the full estimated cost to settle claims

    c. Full costs,[20] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

[20]See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

d. Investing activities, such as buying treasury securities

e. The nature and magnitude of uncertainty to estimate the amounts to be paid to settle future claims, including the basis and estimation method

    i. Significant risk assumptions and factors, including relevant trend information

    ii. How much risk, if any, is shared by third parties

f. The total value of life insurance policies issued—insurance in-force—at the end of the reporting period, which represents the maximum risk exposure[21]

g. The net cash surrender value of policies at the end of the reporting period, including appropriate information to aid in avoiding the misleading inference that there is a more than remote likelihood that 100% of all policies will cancel at the end of the reporting period

h. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

68. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

    b. Claims expenses

    c. CAE[22]

    d. Payments to settle claims

    e. Recoveries and other adjustments

    f. Ending balance

[21] An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

[22] Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

Disclosures Applicable to the Consolidated Financial Report of the U.S. Government

69. The CFR should disclose the following information:[23]

    a. A broad description of insurance programs

    b. A general reference to relevant component reporting entity reports[24]

    c. The balance for insurance program liabilities

    d. A narrative discussion of programs' ability or inability to repay any borrowing

    e. The total amount of coverage provided through insurance in-force as of the end of the reporting period[25]

Effective

70. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018.

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

[23] Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statements."

[24] The term "component reporting 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. These include major departments and independent agencies, which are generally divided into sub organizations, for example, smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations.

[25] Include an explanation about the insurance in-force amount that avoids the misleading inference that there is more than a remote likelihood that claims equal to this maximum risk exposure will be paid at the same time.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by members in reaching the conclusions in this Statement. 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 Statement—not the material in this appendix—should govern the accounting for specific transactions, events or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. The Federal Accounting Standards Advisory Board (FASAB or "the Board") undertook a project to improve the accounting and reporting of all significant risks assumed by the Federal Government. Due to the breadth of the *Risk Assumed* project, the Board decided to break it into multiple phases. These standards address the first phase – *Insurance Programs.* Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.

A2. FASAB undertook insurance programs as phase I of the *Risk Assumed* project because while paragraphs 97-121 in SFFAS 5 include a requirement to report risk assumed for insurance programs, the resulting information as reported by various agencies is not comparable. Further review found that it is challenging to determine the operational results and financial position of insurance programs.

A3. In addition, the Board's conceptual framework now provides a definition of liability and describes measurement attributes that were not available when FASAB developed SFFAS 5. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines liability as "a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording,* defines attributes of elements that may be measured. This Statement adopts the most current concepts so that the accounting principles for insurance liabilities provide comprehensive guidance for consistent reporting.

A4. Project goals are to:

a. define federal insurance programs and related terms,

b. ensure consistent reporting for all insurance programs implemented by the federal government,

c. address measuring uncertainty regarding estimating losses on open arrangements as of the end of the reporting period,

d. ensure disclosures address uncertainties and risk factors, and

e. provide for reporting on significant risks assumed in order to meet the stewardship and operating performance objectives of federal financial reporting.

A5. The Board formed a task force to assist in developing the proposed standards for insurance programs. Task force members included accounting, budget, and insurance subject matter experts from federal agencies and independent public accounting firms.

A6. The task force met several times over the course of the project, delivered an education session to the Board, and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the proposed standards and this Statement.

Summary of Outreach Efforts and Responses

A7. FASAB issued the ED, titled *Insurance Programs*, on December 30, 2015, with comments requested by March 30, 2016.

A8. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A9. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Agriculture Committee
b. House Appropriations Committee
    i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
    ii. Subcommittee on Oversight and Government Reform
    iii. Subcommittee on Homeland Security
c. House Budget Committee
d. House Committee on Veterans' Affairs
e. House Committee on Homeland Security —Subcommittee on Emergency Preparedness, Response, and Communications, Majority
f. House Committee on Financial Services
g. Senate Agriculture Committee
h. Senate Appropriations Committee
    i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
    ii. Subcommittee on Homeland Security
i Senate Committee on Banking, Housing, and Urban Affairs—Subcommittee on Securities, Insurance, and Investment
j. Senate Budget Committee
k. Senate Committee on Finance
l. Senate Committee on Health, Education, Labor & Pensions
m. Senate Committee on Homeland Security and Governmental Affairs
n. Senate Committee on Veterans' Affairs

A10. FASAB received 18 responses from preparers, auditors, professional associations, and citizens. The majority of respondents agreed with proposals for new definitions and exclusions; they also agreed with the three categories: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs for reporting insurance programs.

A11. However, the auditors and accounting associations disagreed with the proposals for how to estimate the settlement of future claims for the liability for losses on remaining coverage.

A12. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A13. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized in the following section.

Key Areas of Improvement

A14. SFFAS 5 resulted in inconsistent reporting among insurance programs due to the absence of definitions and use of terms like possible loss, probable future events, measurable, and uncertainty. The Board considered existing concepts and standards for similar circumstances such as loan guarantees to identify options for improvement. The Board also considered task force testimony that insured events are often hard to project due to their high impact yet low probability nature and the lack of available data to predict them. As a result, the Board determined that current reporting could be improved through:

a. definitions of relevant terms,
b. clarity for what programs are excluded,
c. guidance for revenue recognition and unearned premiums,
d. consistent recognition of liabilities including future loss estimates, and
e. structured disclosure requirements.

Definitions of Relevant Terms and Excluded Activities

A15. During the initial phase of the project, the Board determined that definitions of relevant terms would be necessary for consistent reporting. Staff worked extensively with the task force to develop these definitions. The Board decided to use general terms to include all current insurance and future insurance programs in this Statement. The Board determined that the following provided the foundation for the definitions developed for this project.

a. Insurance Program—while most respondents did agree with the definition, programs that were not structured like commercial insurance programs with actual contracts requested clarification. In addition, respondents found inclusion of the term "non-loan guarantee" in the definition confusing; this was subsequently removed. Therefore, the Board defined a federal insurance program by its fundamental nature. The substance—and not the name—of a program determines if it is an insurance program and therefore subject to these standards.

i. Exclusions—a number of respondents requested clarification on what activities were excluded from this Statement. One respondent requested that the Board expand upon the exclusion of entitlement programs to avoid excluding insurance programs that perform entitlement-like activities but are actually insurance programs.

ii. One respondent recommended including fiduciary funds, workers' compensation programs, and programs established to pay claims on adverse events that occurred in the past.

iii. A number of respondents requested that the Board provide context to explain the exclusions in this proposed standard.

b. Therefore, the Board amended the wording of certain exclusions to aid in assessing the programs and activities that should be excluded.

c. Each of the activities and programs excluded involve risk and, therefore, share a characteristic of insurance programs. The Board concluded that judgment is required in applying the exclusions and that providing context may aid in making such judgments. The rationale for each exclusion is presented below:

i. Programs that administer direct loans and loan guarantees are excluded because standards for these programs are provided in SFFAS 2, *Accounting for Direct Loans and Loan Guarantees.*

ii. Programs that qualify as social insurance are excluded because standards for these programs are provided in SFFAS 17, *Accounting for Social Insurance* (including unemployment insurance).

iii. Programs authorized to engage in disaster relief activities are excluded because while benefits are based on losses from adverse events, coverage is available broadly to the population and benefits may not be as clearly defined as in insurance programs. These aspects make it more challenging to apply the recognition and measurement provisions of this Statement. Disaster relief activities will be addressed in a later phase of risk assumed.

iv. Programs that provide grants are excluded because while grants may be based on losses from adverse events, other criteria make it more challenging to apply the recognition and measurement provisions of this Statement.

v. Programs that provide benefits or financial assistance based on an individual's or a household's income and/or assets are excluded because while an adverse event may be a cause of the income/asset criteria, it is the criteria that determine the benefits or assistance and not the event behind it.

vi. Programs that assume the risk of loss arising from federal government operations; workers' or occupational illness compensation programs; programs that pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency; and programs that indemnify contractors, arrangement partners, and other third parties for loss or damages incurred while or caused by work performed for a federal agency are excluded. The Board updated these exclusions by removing a reference to self-insurance and missions because these terms were unclear to respondents. The Board determined that the cost incurred for such activities and programs are part of the full cost of doing business. For example, a program with fleet vehicles that pays for damage from accidents out of funds designated as operation and maintenance would include such costs in the overall program cost.

d. Adverse Event—each insurance program is responsible for settling losses that result from specific adverse events. The Board learned through an education session with the Federal Crop Insurance Corp that an adverse event may be a single event or a series of events. Therefore, an adverse event has not occurred until all of the events in a series occur.

e. Insurance Arrangement—while most respondents agreed with the term “contract” some respondents noted that they do not have formal contracts and may then be excluded from this Statement. The task force provided information that exchange transaction insurance programs and life insurance programs engage in an explicit agreement or arrangement. The Board decided to change the term from “insurance contract” to “insurance arrangement” to capture the nature of the arrangement as defined by law or regulation. Therefore, the definition of an insurance arrangement includes the elements that insurance programs agree upon to provide settlement of losses to beneficiaries.

f. Insurance Portfolios—one respondent requested that the Board define insurance portfolios and refer to that term consistently throughout the Statement. The Board agreed and added a definition for insurance portfolios.

g. Insurance Program Categories—the Board determined that an insurance program will fit into one of three categories. Each category processes different types of transactions that settle losses from specific adverse events. The categories are as follows:

   i. Exchange transaction insurance programs other than life insurance cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined by SFFAS 7.

   ii. Nonexchange transaction insurance programs cover the risk of loss from adverse events through nonexchange transactions as defined by SFFAS 7.

iii. Life insurance programs cover the risk of loss from death of individuals.

h. A number of respondents requested additional information for better understanding of the exchange and nonexchange transaction categories other than life insurance. In particular, respondents wanted to know (1) how to determine if a program should be classified as a nonexchange transaction insurance program and (2) how to classify a program if it receives both exchange and nonexchange revenue.

i. The Board's intention for the exchange transaction insurance programs other than life insurance and nonexchange transaction insurance programs is to define these categories in relation to the revenue standards in SFFAS 7.

ii. Some respondents were confused by the Board's reference to only SFFAS 7 and not SFFAS 5 in defining these categories. SSFAS 7 and SFFAS 5 each define exchange transactions as occurring when "each party to the transaction sacrifices value and receives value in return."[26] The Board determined that classifying the programs based on the type of revenue received would be straightforward and that no other substantive difference would result.

iii. This Statement addresses revenue recognition that is unique to each category, but does not reiterate the revenue recognition standards. To address this, the Board added a general statement in the Scope section that refers the preparer to other standards when necessary.

iv. The Board notes that some insurance programs may be funded with both exchange and nonexchange revenue. The Board concluded that a program other than life insurance that receives any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

v. Nonexchange transaction insurance programs cover the risk of loss from adverse events through nonexchange transactions, such as collection of nonexchange revenue or use of appropriations. For example, some levy:

(1) excise taxes which, like other taxes, are determined by the government's power to compel payment and are classified by SFFAS 7, paragraph 243 as nonexchange revenue;

(2) surcharges which, like excise taxes, are determined by the government's power to compel mandatory recoupment of the federal share of pay for losses.

[26] See SFFAS 5, par. 22, and SFFAS 7, par. 33.

Revenue Recognition and Liability for Unearned Premiums

A16. Exchange transaction insurance programs other than life insurance recognize revenue in proportion to the insurance protection to be provided. Any revenue collected but not earned prior to the end of the reporting period is recognized as unearned premiums.

a. The following is an example of revenue that is earned evenly over a 12-month arrangement period because insurance protection is provided evenly during the arrangement period. The premium of $1,200 is collected on July 1. By September 30, three months have been covered earning the exchange program $300. The remaining $900 is unearned because the remaining arrangement period is still open into the next fiscal year: from October 1 through June 30. The $900 is recognized separately on the balance sheet as unearned premium.

b. The following is an example of revenue that is earned for three equivalent national rallies held during a 12-month arrangement period. The premium of $1,500 is collected on July 1. By September 30, two of the three rallies have occurred, earning the exchange program $1,000. The remaining $500 is unearned because the third rally is not scheduled until December 20, which is during the remaining arrangement period from October 1 through June 30. The $500 is recognized separately on the balance sheet as unearned premium.

A17. Nonexchange transaction insurance programs do not recognize unearned premiums because they do not earn premiums. The Board believes that insurance programs in this category should apply general revenue recognition standards. Therefore, no specific revenue recognition guidance is provided in this Statement.

A18. Life insurance programs do not recognize unearned premiums. The Board concluded that revenue from life insurance arrangements should be recognized when due from policyholders because there is no better basis for determining when revenue is earned. Premiums are due and collected each pay period or on another recurring basis over the entire duration of the arrangement. In addition, the expected present value of future net premiums is deducted from the expected present value of future claims to arrive at the liability for future policy benefits.

Recognition of Liabilities and Measurement of Future Loss Estimates

A19. Liability for unpaid claims is recognized for all categories. Regardless of category, at the end of the reporting period insurance programs might be processing claims for losses due to adverse events that occurred by the end of the reporting period.

a. The amounts due for claims that have been submitted but not paid are included in the liability for unpaid claims.

b. There are also claims IBNR. The amounts for these claims are not known and must be estimated for adverse events that occurred by the end of the reporting period. If an adverse event is a series of events not completed by the end of the reporting period, then the Board concluded that these are not claims IBNR and should not be included in the liability for unpaid claims. Nonetheless, for exchange transaction insurance programs other than life insurance, such series should be considered in estimating a liability for losses on remaining coverage.

c. Claims adjustment expenses are costs directly related to settling claims from adverse events that occurred by the end of the reporting period. The Board concluded that CAE should be included in the liability for unpaid claims for submitted and IBNR claims to recognize the full cost to settle claims.

A20. Recognition of a liability for losses on remaining coverage is required for exchange transaction insurance programs other than life insurance.

a. Research by the task force determined that a program has a service obligation to pay for any losses caused by adverse events during the entire arrangement period. The Board agrees and therefore decided to separate the liability for losses on remaining coverage from the liability from the unpaid claims portion.

b. The Board concluded that recognizing a reasonable estimate of future losses for the open arrangement period that extends beyond the end of the reporting period will remove ambiguity created by SFFAS 5 standards to recognize contingency liabilities.

c. According to SFFAS 5, paragraph 38, contingent liabilities must be recognized if a past transaction has occurred and a future outflow or other sacrifice of resources is probable and measureable. Under the new standards, the liability for losses on remaining coverage is the estimated future cash flows arising from adverse events that are expected to happen during the period that coverage will be provided. Therefore, the Board's next challenge was how to consistently address uncertainty regarding measurement.

d. Task force research showed that federal insurance programs were using a variety of statistical modeling methods to estimate future losses depending on their unique uncertainties and risk factors. For example, the Department of Agriculture's Risk Management Agency oversees crop insurance and relies upon a regression analysis;[27] the Department of Homeland Security's Federal Emergency Management

[27] Regression analysis is a statistical technique used to measure the extent to which a change in one quantity (variable) is accompanied by a change in some other quantity (variable). GAO, Aug 1, 1974-Case Study (CS-5), *Using Regression Analysis To Estimate Costs Published*, page 1.

Agency oversees flood insurance and relies on a lognormal distribution;[28] and the National Credit Union Administration uses an internal econometric model that applies estimated failure and loss rates, taking into account the historical loss history, insuree, risk ratings, insuree financial ratios, and other conditions.

e. To address such measurement challenges, the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 7, paragraphs 44-54, describes a variety of pricing tools and methods for developing an expected cash flow estimate.

f. To allow for a variety of estimating methods for federal insurance programs, the ED required that programs should first use expected cash flow to estimate the cost to settle claims on remaining coverage. The ED acknowledged that there would be various methods available to estimate cash flows and probabilities. Further, the proposal provided that if expected cash flow estimates were not practical and appropriate, then an entity could estimate a single most-likely amount to be paid to settle future claims during the remaining open arrangement period.

g. A number of respondents were concerned with implementation of and auditing to the terms “practical and appropriate.”

h. In addition, one member believed that the entity should be able to use any method that provides a reasonable estimate of cash flows, based on all available information existing at the balance sheet date, including experience with previous trends, and, as appropriate, the views of independent experts. However, the majority of members still preferred expected cash flow to estimated cash flow. After discussion, all members agreed to allow any method for which the objective is a reasonable estimate of expected cash flows. This allows management the flexibility to choose a method that produces a reasonable estimate of expected cash flows specific to the program’s future adverse event uncertainties and risk factors.

A21. Recognition of a liability for future policy benefits is required for life insurance programs. Future benefits and premiums are estimated using financial and/or actuarial methods, depending on the portfolio risk characteristics and arrangement duration. These amounts are discounted to the present value to recognize the liability for future benefits.

[28] In statistics the best known distribution is the normal, the familiar bell-shaped curve which is symmetrical about its mean. Certain other distributions stem from the normal. For example… the lognormal distribution…A random variate x is lognormally distributed if the logarithm of x is normally distributed. In short, the distribution of x is itself lognormal when the distribution of log x is normal. A typical lognormal distribution is skewed to the right and has a lower bound such that the probability of x being less than this lower bound is exactly zero. Lester G. Telser, Review of the Lognormal Distribution, Journal of Farm Economics 41. No 1, Feb., 1959, page 161.

A22. Estimates for the liability for losses on remaining coverage and future policy benefits are recognized by insurance portfolios with similar characteristics, including arrangement duration. The Board decided not to define “arrangement duration” due to the subjective nature of duration. For example, one insurance program might determine that a 36-month arrangement is short-duration, while another assigns the arrangement to a long-duration group. Recognizing these liabilities by groups of arrangements allows judgment by each insurance program in defining the duration of their arrangements.

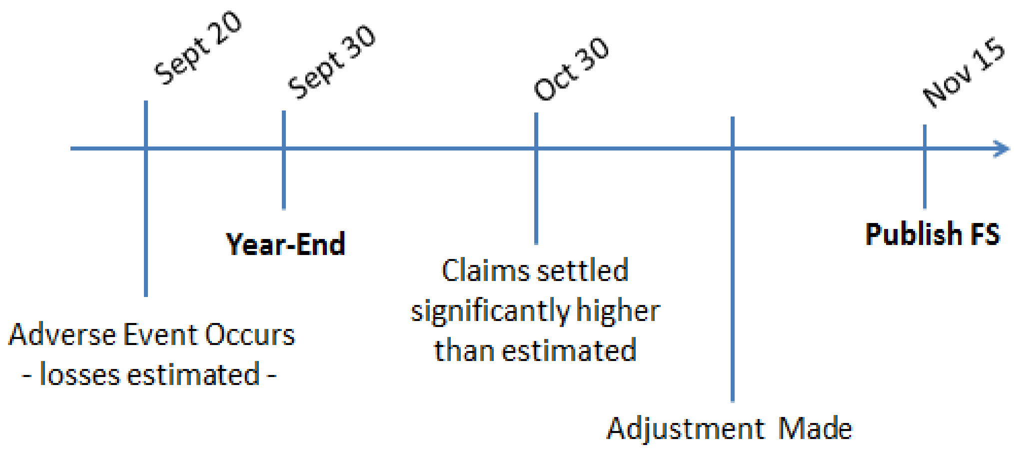
Subsequent Events

A23. Certain respondents requested clarification regarding subsequent events and the application of SFFAS 39 in relation to whether these standards are to add to or supplement SFFAS 39. The Board determined that the treatment of subsequent events should differ for the liability for unpaid insurance claims versus the liability for losses on remaining coverage as follows.

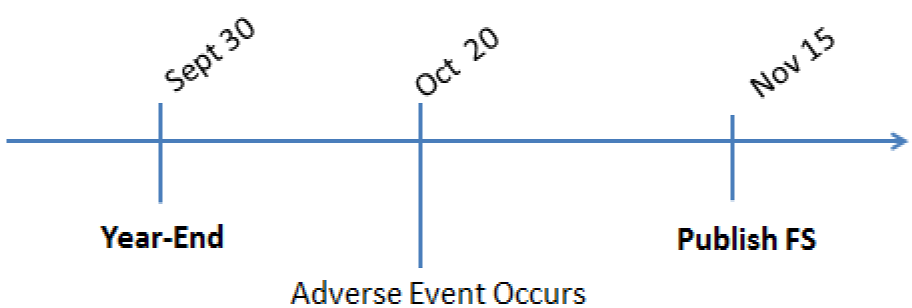
Liability for Unpaid Insurance Claims

A24. For the liability for unpaid insurance claims, events or transactions occurring after the balance sheet date but before the financial report is issued are considered subsequent events. A subsequent event may or may not result in the adjustment of the financial statements, depending on whether it is a recognized or nonrecognized event. See SFFAS 39 for detailed guidance. Examples of subsequent events for insurance programs with a September 30 year-end and a November 15 financial statement (FS) publication date may include the following.

a. Recognized event: claims settled on October 30 for an amount significantly different from the liability recorded for a major disaster that occurred on September 20 would require adjustment to the liability for unpaid claims in the financial statements.



b. <u>Nonrecognized event:</u> a major disaster that occurs on October 20 would not require an adjustment to the financial statements but may require disclosure.



Liability for Losses on Remaining Coverage

A25. The liability for losses on remaining coverage estimates future events. Due to the uncertainty of the occurrence, magnitude, and timing of these future events, the Board decided that all subsequent events relating to the liability for losses on remaining coverage should be classified as nonrecognized events in accordance with SFFAS 39, paragraph 15.

Disclosures

A26. Disclosures are required for each insurance program category to aid the reader in understanding the estimates and fiscal health of insurance programs in relation to the risk they assume for losses incurred due to adverse events.

Avoiding Duplicity of Information

a. Task force research informed the Board that current standards required presentation of similar information in multiple places (for example, notes and required supplementary information), which burdened the agencies and readers. In addition, disclosures were inconsistent among programs, making it difficult to determine the fiscal health—the amount of loss estimated versus the amount and funding types necessary to settle the actual losses—of individual programs as well as insurance programs at the government-wide level.

b. The Board concluded that the updated disclosures will avoid duplication by allowing insurance programs to reference relevant notes.

Changes in the Liability for Unpaid Insurance Claims

c. For consistent reporting, the Board requires a reconciliation of the liability for unpaid claims that a number of insurance programs already produce. The Board reviewed the current reconciliations and consolidated relevant information for consistent reporting. All categories should report this information so readers receive consistent information.

d. The Board concluded that requiring disclosure of full costs, premiums collected, appropriations used, borrowing needed during the reporting period, as well as the ability to repay the borrowing should provide a holistic picture of an insurance program's performance.

Insurance In-Force

e. The Board concluded that disclosing the balance of insurance in-force as of the end of the reporting period will provide useful information as to the maximum risk exposure to the program. However, one respondent requested, and the Board subsequently agreed, to update the standard to provide more clarity on how the program should explain that paying the full amount of insurance in-force is very unlikely.

Low Probability, High Impact Adverse Events-Uncertainty

f. Some respondents were concerned about how to disclose the uncertainty of adverse events, including those that are low probability, high impact (very rare, but upon occurrence causes extreme loss). The Board understands that uncertainty is subjective to each insurance program in relation to the risks it insures—which may cause extreme loss that is hard to estimate. Some programs may also encounter uncertainty in relation to a multitude of events that must occur over time and often do not occur within one reporting period.

   i. The following are examples of hard to predict adverse events that may cause substantial losses: a “Katrina” type[29] of hurricane, a political uprising in a country that completely disrupts American businesses, or an unusual detrimental weather pattern combined with volatile commodity pricing.

   ii. Due to this uncertainty in magnitude and timing, the Board concluded that the disclosure about estimating uncertainty allows management to discuss its particular constraints in determining the liability for losses on remaining coverage.

Disclosures – Financial Report of U.S. Government

A27. Disclosures for the financial report of the U.S. Government should be reported at a high level of detail. The Board concluded that detailed disclosures should be found at the component reporting entity level.

Board Approval

This Statement was approved unanimously. Written ballots are available for public inspection at FASAB’s office.

[29] Per FEMA - Hurricane Katrina was a long-lived hurricane that made landfall three times along the United States coast and reached Category 5 at its peak intensity... CNN reported that …Hurricane Katrina is the costliest disaster in the history of the global insurance industry. The National Flood Insurance Program paid out $16.3 billion in claims...Private Insurance companies have paid an estimated $41.1 billion in claims.

Appendix B: Abbreviations

CAE	Claim adjustment expense
CFR	Consolidated financial report of the U.S. Government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IBNR	Incurred but not reported
OMB	Office of Management and Budget
RSI	Required supplementary information
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 52: Tax Expenditures

Status

Issued	May 31, 2017
Effective Date	For periods beginning after September 30, 2017. Earlier implementation is encouraged.
Affects	None.
Affected by	None.

Summary

This Statement requires certain information on tax expenditures to assist users of the consolidated financial report of the U.S. Government (CFR) in understanding the existence, purpose, and impact of tax expenditures.

Specifically, this Statement requires that the CFR:

1. Include narrative disclosures and information regarding tax expenditures that inform the reader regarding the:
    a. definition of tax expenditures,
    b. general purpose of tax expenditures,
    c. impact on and treatment of tax expenditures within the federal budget process, and
    d. impact of tax expenditures on the government's financial position and condition.
2. Alert readers regarding the availability of published information on tax expenditure estimates, such as those published annually by the Department of the Treasury's Office of Tax Policy.

This Statement also encourages presentation of tax expenditure estimates as other information (OI)[1] in the CFR.[2]

[1] The term *Other Information* (OI) used in this Statement and the term *Other Accompanying Information* (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

[2] Although the Federal Accounting Standards Advisory Board (FASAB) does not require OI to be presented, FASAB may at times encourage voluntary reporting of items to help in the development of information that may enhance overall federal financial reporting. For example, FASAB may consider an item to be relevant to entity operations but, for the moment, does not meet other criteria for required information.

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.

Table of Contents

Standards

Scope

1. This Statement requires narrative disclosures and information regarding tax expenditures, and it encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by the Department of the Treasury's (Treasury) Office of Tax Policy, as other information (OI) in the consolidated financial report of the U.S. Government (CFR).[3]

2. The reporting requirements in this Statement apply to the CFR. They do not apply to the financial statements of component reporting entities. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.

3. This Statement does not alter or contradict the definition of tax expenditures, as established by the Congressional Budget and Impoundment Control Act of 1974. This Statement does not affect the Treasury or the Joint Committee on Taxation's (JCT) interpretation of the statutory definition. Hence, this Statement does not affect the policies and practices of Treasury's Office of Tax Policy or the JCT with respect to the definition, identification, recognition, and measurement of tax expenditures.

Definitions

4. <u>Tax expenditures</u>

   The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344) defines **tax expenditures** as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

   While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly

[3] The term other information (OI) used in this Statement and the term other accompanying information (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

5. Baseline provisions

Baseline provisions are the starting points used to measure the impact of tax expenditures on tax revenues as compared to revenues that would be collected otherwise, absent the special exclusion, exemption, deduction, credit, preferential rate, or deferral. Certain practical aspects of the tax code are incorporated into the baseline-such as progressive tax rates, personal exemptions, standard deductions, deductions of expenses incurred in order to earn income, and deferrals of unrealized income.

DISCLOSURE REQUIREMENTS

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

6. Disclosures about tax expenditures should help provide readers with a general understanding of how tax expenditures affect the government's tax collections, financial position, and financial condition; and how budgetary objectives can be achieved through the mechanism of tax expenditures.

7. Disclosures within the notes to the financial statements should include:

   a. a "plain language" definition of the term tax expenditures;[4]

   b. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions; and

   c. a description of how tax expenditures affect nonexchange revenue, tax collections, and refunds, as well as whether tax expenditure amounts are presented in the basic financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

8. Management's discussion and analysis (MD&A) should include:

[4]This Statement does not establish the wording of the "plain language" definition.

a. a "plain language" definition of the term tax expenditures;

b. the general purpose of tax expenditures;

c. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions;

d. information about other factors that may affect tax collections in order to place tax expenditure information in an appropriate context;

e. a description of how tax expenditures are treated for budgetary and financial reporting purposes, including their impact on the surplus or deficit and their treatment within the federal budget process, and how they affect the government's financial position and condition; and

f. a statement regarding the availability of published information on tax expenditures, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

OTHER INFORMATION

9. The Federal Accounting Standards Advisory Board (FASAB or "the Board") encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by Treasury's Office of Tax Policy, as OI in the CFR.

10. The Board encourages the presentation of tax expenditure estimates in a manner that informs readers of:

    a. the general magnitude of tax expenditures and their impact on federal revenues (revenue effect) during the fiscal year;

    b. the source of the estimates; and

    c. the availability of published information wherein the estimates presented in OI were originally published, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

EFFECTIVE DATE

11. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017. Earlier implementation is encouraged.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

INTRODUCTION

A1. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards. The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

a. This Statement contributes to Objectives 1, 2, and 3.

i. Objective 1, Budgetary Integrity, states 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.

1. Sub-objective 1A states that:

> Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used …

2. Sub-objective 1C states that:

Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

ii. Objective 2, Operating Performance, states that:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed…

iii. Objective 3, Stewardship, states that:

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 conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

A2. Tax expenditures reduce federal revenues as a result of tax legislation. These reductions have historically been measured relative to normal baseline provisions of an individual and corporate income tax system. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds by federal agencies and programs. Accordingly, the Board sought to provide budgetary information, which contributes to Objective 1. In particular, such tax expenditure information should contribute to sub-objectives 1A and 1C by providing information to assist readers in understanding how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

A3. Tax expenditures may be used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory programs. The Board believes that the service efforts, costs, and accomplishments of the reporting entity-the U.S. government-include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, financial reports should provide operating performance information, which contributes to Objective 2.

A4. Because tax expenditures may be viewed as alternatives to spending or regulatory programs, they can also be viewed as government investments of forgone budgetary resources designed to address policy objectives. Thus, individual tax expenditures may affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and/or (3) the nation's current and future well-being. Accordingly, financial reports should provide stewardship information, which contributes to Objective 3.

PROJECT HISTORY

A5. In October 2014, the Board approved this project in order to determine what information regarding tax expenditures should be included in general purpose federal financial reports (GPFFRs). The decision followed an October 2013 educational briefing to the Board that resulted in identifying the topic as a high priority.

A6. Throughout the project, the Board relied on a task force that included experts in the areas of tax expenditures, tax policy, and federal financial reporting. The task force provided critical assistance and knowledge to the Board and FASAB staff in developing (1) recommendations to the Board, (2) Appendix B: Tax Expenditures Explained, and (3) illustrations that were included in the exposure draft (ED). The task force also provided technical comments and feedback on working drafts and attended Board meetings to answer technical questions and provide insight during deliberations.

A7. In December 2015, the task force issued its Report to the FASAB, which included three recommendations to the Board and three options for the Board's consideration with respect to the presentation of tax expenditure estimates in the CFR.

a. The first recommendation of the task force was to include an introduction section or background paper, as drafted by the task force, to educate readers of and respondents to the Board's ED and the final Statement regarding tax expenditures.

   i. The Board approved this recommendation to be implemented in a proposed standard, but elected to include a condensed introduction section along with the full background paper developed by the task force (with minor changes) as an appendix section (Appendix B: Tax Expenditures Explained). This recommendation was ultimately implemented in this Statement.

b. The second recommendation of the task force was to require certain narrative disclosures regarding tax expenditures within the notes to the financial statements and MD&A of the CFR.

   i. Task force members decided early in the project that they did not generally support issuing proposed standards that affected component reporting entities of the federal government due to potentially significant challenges and costs associated with doing so. For example, implementing accounting standards for identifying tax expenditures that are key performance or financial indicators for a component reporting entity could be time consuming and costly to the preparer.

   ii. The task force concluded that this recommendation would improve users' awareness and understanding of tax expenditures while avoiding extensive, voluminous, or costly disclosures.

   iii. The Board approved the recommendation to be implemented in a proposed standard with certain minor changes to the recommendation as written in the task force report. This recommendation was ultimately implemented in this Statement.

c. The third recommendation of the task force was to require the inclusion of hyperlinks in the CFR to inform readers regarding other online sources of information where readers of the government-wide report can obtain more detailed information regarding tax expenditures.

   i. FASAB staff worked with members of the task force and other members of the federal financial statement auditing community to develop proposed language for implementing this recommendation.

   ii. The Board discussed how best to implement this recommendation. Board members came to the conclusion that the language in paragraph 8.f provides discretion to the preparer to embed a hyperlink to information sources that it deems to be most appropriate, should reporting on tax expenditures evolve, expand, or improve in the future.

   iii. The Board sought to develop a requirement that would continue to be relevant in the future and also allow the preparer to exercise discretion in selecting information sources that are referenced in the CFR.

iv. Board members determined that implementing the requirement in paragraph 8.f will likely necessitate the use of electronic hyperlinking in the CFR, given (1) the costs and burdens of using alternative methods for implementing the requirement, such as postage and printing costs, and (2) the availability and minimal costs associated with hyperlinking to electronic information available on the internet. The Board encourages the use of hyperlinks in implementing the requirement.

v. The Board concluded that the requirement in paragraph 8.f makes it sufficiently clear to the preparer and auditor that the reader should be informed that the information referenced is unaudited. Moreover, the Board concluded that MD&A was an appropriate section for directing users to unaudited reports.

d. Options for consideration proposed by the task force regarding the presentation of tax expenditure estimates were to (1) encourage the inclusion of tax expenditure estimates as OI in the CFR, (2) require the inclusion of tax expenditure estimates within required supplementary information (RSI) of the CFR, or (3) neither encourage nor require the inclusion of tax expenditure estimates within the CFR and focus exclusively on narrative content and links to other resources for comprehensive reporting of estimates.

i. Task force members who supported the placement of tax expenditure estimates in OI were primarily concerned about the quality, timeliness, and availability of reliable data upon which these estimates are based. These task force members were also concerned that existing differences in the list of tax expenditures identified by two credible sources of such estimates-Treasury's Office of Tax Policy and the JCT-may pose challenges, particularly if such information were audited. Additionally, estimation methodologies for certain tax expenditures can neither be tested nor improved over time by way of assessing their historical performance against tax return data or transactions; assessing historical performance for certain tax expenditures requires the use of data that are not collected on tax returns or otherwise available because these estimates are imputed rather than based on recordable transactions that actually occurred. Task force members supporting the inclusion of estimates in OI believed that these unique challenges impede the preparer's ability to (1) identify a generally accepted universe of tax expenditures; (2) develop estimates generally accepted as reliable, fair, and correctly measured; and (3) include estimates within RSI or basic information without negative or potentially unresolvable audit challenges.

ii. These members recommended-and the Board ultimately concluded-that encouraging the inclusion of estimates in OI avoids such costs and challenges, increases transparency and context surrounding the general magnitude and impact of tax expenditures on the government's financial position, and elevates tax expenditure estimates into an unaudited section of the CFR to create more transparency.

REQUIREMENT FOR INFORMATION IN MD&A AND NOTES

A8. The Board concluded that the CFR's MD&A should include a discussion of tax expenditures, their general purpose, and how they affect the government's financial position and condition. This Statement also requires discussion of other factors that may affect tax collections in order to place tax expenditure information in an appropriate context. The specific requirements are presented in paragraph 8 and sub-paragraphs 8.a-8.f.

A9. Requiring information on tax expenditures in the MD&A and notes to the financial statements in the CFR is important for the following reasons:

a. Discussion regarding the topic of tax expenditures is currently absent; however, tax expenditures have had a significant impact on the federal government's financial position, tax collections, and performance outcomes each year. The significant impact of tax expenditures warrants discussion in MD&A because MD&A should "provide a clear and concise description of the reporting entity and its … activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition."[6]

b. Tax expenditures are significant to the management, budgetary, and oversight functions of the Congress and the Administration. Tax expenditures are often used by the federal government as a mechanism to address policy objectives. Tax expenditures may also affect the judgment of citizens about the efficiency and effectiveness of the tax code in accomplishing certain financial or policy objectives. Therefore, tax expenditures are consistent with the provisions of Statement of Federal Financial Accounting Standards 15, paragraph 6, which states:

   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

[6] Statement of Federal Financial Accounting Standards 15, par. 1.

source of information. … Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

i. lead to significant actions or proposals by top management of the reporting unit;
ii. be significant to the managing, budgeting, and oversight functions of the Congress and the Administration; or

iii. significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.

c. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.[7] The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

d. Objective 1, Budgetary Integrity, states 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.

i. Sub-objective 1A states that:

Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used …

ii. Sub-objective 1C states that:

Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

e. Tax expenditures reduce federal revenues via tax legislation. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing

[7] SFFAC 1, par. 109.

budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds to federal agencies and programs. Accordingly, the MD&A and financial statement note requirements in this Statement will provide budgetary information and contribute to addressing Objective 1. In particular, the disclosure requirements will contribute to addressing sub-objectives 1A and 1C because these disclosures provide readers with an understanding of how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

f. Objective 2, Operating Performance, states that:

   Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed; and the management of the entity's assets and liabilities.

g. Tax expenditures are used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory programs. The service efforts, costs, and accomplishments of the reporting entity-the U.S. government-include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, this Statement will result in information that alerts readers to the efforts and costs associated with tax expenditures and, therefore, will provide operating performance information and contribute to addressing Objective 2.

h. Objective 3, Stewardship, states that:

   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 conditions have changed and may change in the future.

   Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

i. Because tax expenditures are often viewed as alternatives to spending or regulatory programs, they can be viewed as government investments of forgone budgetary resources designed to address policy objectives. Thus, tax expenditures affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and (3) the nation's current and future well-being. Accordingly, the Board concluded that the requirements for MD&A and notes to the financial statements in the CFR provide stewardship information and contribute to addressing Objective 3.

A10. Requiring information on tax expenditures in the notes to the financial statements in the CFR is important for the following reasons:

a. The requirements will help readers understand that the tax system is used to accomplish policy goals as well as collect revenue.

b. The requirements will help readers understand that some "efforts" and related costs are not transparent in the financial statements but do affect them.

c. The requirements provide context of other factors affecting tax collection in order to place tax expenditures in an appropriate context and help readers to have a more complete understanding of factors affecting the government's financial position and condition.

A11. The information reported in accordance with the requirements of this Statement for MD&A and the notes to the financial statements in the CFR will improve users' awareness and understanding of tax expenditures, their use, and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.

A12. The information reported in accordance with requirements of this Statement will help users to evaluate and understand (1) the impact of the tax code on budgetary resources and uses; (2) the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed and/or affected by the tax system; and (3) how the tax code relates to and/or affects the government's investments and financial position, and how the government's financial condition has changed and may change in the future as a result.

REPORTING ESTIMATES IN OTHER INFORMATION

A13. Regarding cost-benefit considerations, SFFAC 1, paragraph 155 states that "for many purposes, other information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective." Paragraphs 9-10 of this Statement provide readers with a means of easily accessing other relevant tax expenditure information sources.

A14. Regarding the inclusion of estimates in OI and informing readers of the source and availability of published information wherein the estimates were originally published; the Board concluded that suitable amounts of detail, context, and explanations can accompany estimates presented in a reasonably concise manner while also meeting the needs of users with different levels of knowledge regarding tax expenditures. Accordingly, the inclusion of statements to alert readers that the published information includes a complete population of the tax expenditure estimates identified by the reporting party and whether such information includes details of the estimating conventions and explanatory definitions of the tax expenditures presented in OI would also be helpful to users.

A15. The Board may elect to evaluate the costs, limitations, benefits, and other implications of developing additional measurement, recognition, and disclosure guidance in the future.

A16. Given the conceptual issues that make tax expenditures unauditable, before any future efforts are potentially undertaken, the following matters need to be considered:

a. How best to define, identify, and measure tax provisions that are both relevant for financial reporting purposes and generally accepted by economists and other experts

b. Whether it is feasible to develop estimates that are considered to be representationally faithful, consistent, comparable, and auditable

c. If auditability can be achieved, what considerations would enable the preparer and auditor to achieve their respective responsibilities in a reasonably effective and efficient manner

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A17. The ED was issued June 2, 2016, with comments requested by September 15, 2016. Upon its release, notices and press releases were sent to the following organizations:

a. The *Federal Register*;

b. *FASAB News* and the related listserv subscribers, including:

i the *Journal of Accountancy, AGA Today, Accounting Today*, the *CPA Journal*, *Government Executive* and the *CPA Letter*;

ii the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network;

iii committees of professional associations generally commenting on FASAB EDs in the past; and

iv other individuals and organizations in the federal accountability community.

A18. This broad announcement was followed by electronic mailings of the ED and subsequent reminder notices to:

a. Relevant congressional committees, including:

i. the House Committee on Oversight and Government Reform,

ii. the Senate Committee on Homeland Security and Governmental Affairs,

iii. the House Committee on Ways and Means,

iv. the Senate Committee on Finance,

v. the House Committee on the Budget,

vi. the Senate Committee on the Budget, and

vii. the JCT;

b. Non-profit, public policy, and accounting organizations, such as:

i. state and territorial CPA societies,

ii. accounting, tax, and public policy and research organizations,

iii. accounting and auditing firms, and

iv. taxpayer associations;

c. Individuals that have published articles, commentary, and/or research regarding tax expenditures, such as:

i. college professors,

ii. economists, and

iii. tax policy analysts.

A19. The Board did not rely on the number 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 considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A20. FASAB received 12 responses from federal agencies, users of federal financial information, and professional associations. The majority of respondents agreed with the proposed requirements in the ED, which are implemented in this Statement in paragraphs 6-8 and the related sub-paragraphs.

A21. However, some respondents disagreed with Board proposals in the ED to encourage the presentation of major tax expenditure estimates in OI in a manner that informs readers of the general magnitude of tax expenditures and their impact on federal revenues. A few respondents viewed RSI as a more appropriate classification for the information. Other respondents expressed a preference to exclude estimates from the CFR altogether and refer readers to external resources wherein comprehensive reports and estimates can be obtained.

A22. The Board carefully considered respondents' views and found them to be consistent with the considerations, costs, benefits, and views expressed by task force and Board members in earlier deliberations.

A23. The Board concluded that it would not be appropriate to change the ED proposal from encouraging the presentation of major tax expenditure estimates from external sources in OI to requiring such information in RSI. Such a change would classify the information as required information. For reasons discussed in paragraphs A7.d.i and A16, the Board concluded that such a requirement must be preceded by the development of recognition and measurement criteria.

A24. The Board also concluded that it would not be appropriate to remove the ED proposal to encourage the presentation of major tax expenditure estimates. For reasons discussed in paragraph A7.d.ii, the Board maintains that the implementation of paragraphs 9-10 and the related sub-paragraphs will enhance user awareness and understanding of tax expenditures and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.

A25. One respondent expressed that requirements to report on tax expenditures should also be extended to at least certain component reporting entities. The respondent noted that many component reporting entity objectives and achievements are financed as much through tax expenditures as through outlays.

A26. The Board agrees that tax expenditures contribute to component reporting entity performance objectives and costs inherent to the achievement of those objectives. In its review of the respondent's comment letter, the Board concluded that cost-benefit considerations regarding its decision not to extend requirements to component reporting entities should be clarified in the basis for conclusions.

A27. The Board concluded early in the project that there is strong evidence of significant challenges to identifying and assigning tax provisions and aligning those provisions with agency goals. Board members considered problems identified in a Government Accountability Office (GAO) report issued in July 2016,[8] including the following:

a. There is a continuing lack of clarity about the roles of different federal agencies in conducting reviews of tax expenditures. This lack of clarity can lead to inaction in identifying tax expenditures' contributions to agency goals.

b. Whether or not agencies have a defined role in administering tax expenditures influences whether those agencies identify tax expenditure contributions to their goals.

    i. If agencies do not have a defined role in administering a tax expenditure, they may choose not to identify the tax expenditure's contributions to their goals.

    ii. The agencies that linked tax expenditures to performance measures typically had a defined role in administering them, and therefore collected data on those tax expenditures.

A28. Before efforts can be undertaken by FASAB to extend requirements to component reporting entities, many issues need to be considered and deliberated by the Board, such as:

a. how best to define and identify tax provisions that are relevant for financial reporting purposes,

b. the extent to which a component reporting entity's role in administering a tax provision should affect recognition of that tax provision for financial reporting purposes,

c. the extent to which the alignment of a component reporting entity's missions, goals, and objectives with the accomplishments of a tax provision should affect recognition of that provision for financial reporting purposes, and

[8] GAO, T*ax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, GAO-16-622 (Washington, D.C.: July 7, 2016).

d. the types of information most relevant to users of GPFFRs and how this information should be presented therein, if at all.

A29. A few respondents expressed concerns about or provided suggested edits to an illustration included in the ED.

A30. Instead of addressing comments on the illustration, the Board elected to remove the illustration from the ED for the following reasons:

a. The primary purpose of the illustration was to enable ED respondents to envision how the proposed requirements might be implemented in the CFR.

b. The illustration was in a non-authoritative appendix.

c. There is only one CFR. Treasury and the Office of Management and Budget (OMB) officials expressed that including such an illustration in the final Statement was not essential to understanding provisions of the standard.

d. The illustration may become outdated as the CFR preparer may develop more innovative ways to present information and/or as tax policy evolves.

BOARD APPROVAL

A31. This Statement was approved by the Board with a vote of seven members in favor of its issuance and two members, Ms. Ho and Mr. Reger, abstaining from the vote. Written ballots are available for public inspection at the FASAB office.

Appendix B: Tax Expenditures Explained

Purpose

In light of the Board's mission to improve federal financial reporting, it is paramount that such reporting assists report users in evaluating the service efforts, costs, accomplishments, and fiscal sustainability of the federal government and in understanding how these efforts and accomplishments have been financed. Although tax expenditures have similarities to federal spending in their impact on service efforts, costs, accomplishments, and fiscal sustainability; they have historically received little focus in general purpose federal financial reporting. Establishing reporting requirements with respect to this topic requires an understanding of tax expenditures, the methods used to estimate income tax expenditures, and considerations in using those estimates.

This section provides an overview of tax expenditures to aid preparers and users in understanding reporting in regard thereto. Specifically, this section:

1. defines tax expenditures and describes the six types of tax expenditures;

2. provides context with respect to the purpose of tax expenditures, why they are important, and their relationship to government performance, taxpayer behaviors, and the economy; and

3. summarizes how tax expenditure estimates are prepared by Treasury. This ultimately affects how tax expenditure estimates can be used and interpreted.

Background

The Congressional Budget and Impoundment Control Act of 1974 (the Budget Act) defines tax expenditures as

"…revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." (Section 3(a)(3) of Public Law 93-344)

Generally, tax expenditures are provisions in the tax law available to certain subsets of taxpayers who engage in certain activities, face special circumstances, or otherwise meet certain criteria. The government uses tax expenditures to stimulate behavior that will accomplish public policy goals such as facilitating homeownership, reducing the cost of borrowing for state and local governments, encouraging higher education, or promoting domestic energy production.

Tax expenditures are "revenue losses" in that the provisions reduce income taxes owed and, therefore, revenue collected. Tax expenditures resemble federal spending in that such provisions affect the federal deficit/surplus by impacting income tax revenue; however, tax expenditures are often not treated the same as federal spending for budgetary or financial reporting purposes.[9] Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Many tax expenditures can only be removed or changed through tax legislation. While tax expenditures help determine the government's net revenue, tax expenditure estimates are not explicitly displayed in the Statements of Net Cost or Changes in Net Position.

How Tax Expenditures Are Identified

The first step in identifying tax expenditures is defining the tax baseline so that the provisions considered "special" (per the Budget Act definition above) can be distinguished from those provisions consistent with a baseline tax system. Traditionally, for the federal income tax, the baseline tax system is a comprehensive income tax with certain practical provisions that are generally accepted as being part of a baseline tax system. Accordingly, provisions such as the personal exemption, standard deductions, deductions of expenses incurred in earning income, and a progressive rate structure are considered to be part of the baseline tax system for measurement purposes.

Judgments about such provisions are based on a general consensus view of analysts regarding practical provisions of a baseline tax system versus "special" provisions that constitute a tax expenditure. For example, the personal exemption and standard deduction are viewed as defining a zero-rate bracket that is part of baseline tax law as are the other graduated rate brackets in the individual income tax. In contrast, the child tax credit is considered a tax expenditure because it provides a "special" benefit that would not exist under baseline tax law.

[9] In certain cases a tax preference may provide cash in the form of a refundable tax credit even if the taxpayer owes no tax. The budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer's tax liability as outlays. As such, a portion of this type of tax preference is reported as outlays in the budget to the extent payments exceed the taxpayer's liability, whereas the portion offsetting the taxpayer's liability reduces budget revenues but is not explicitly reported in the budget.

After determining the baseline tax system, the credits, deductions, special exceptions and allowances that reduce tax liability below the level implied by the baseline tax system are then considered to be tax expenditures.

Types of Tax Expenditures

There are six types of tax expenditures—exclusions, exemptions, deductions, credits, preferential rates, and deferrals. below describes each and provides an example.

Table 1: Examples of Provisions That Are Tax Expenditures When They Are Exceptions to the Normal [Baseline] Tax Structure

Tax expenditure	Description	Examples
Exclusion	Excludes income that would otherwise constitute part of a taxpayer's gross income.	Employees generally pay no income taxes on contributions their employers make on their behalf for medical insurance premiums.
Exemption	Reduces gross income for taxpayers because of their status or circumstances.	Taxpayers may be able to reduce their tax liability if they have a dependent who is a child aged 19 through 23 and is a full-time student.
Deduction	Reduces gross income due to expenses taxpayers incur.	Taxpayers may be able to deduct state and local income taxes and property taxes.
Credit	Reduces tax liability dollar-for-dollar. Additionally, some credits are refundable meaning that a credit in excess of tax liability results in a cash refund.	Taxpayers with children under age 17 potentially can qualify for up to a $1,000 partially refundable, per child credit, provided their income does not exceed a certain level.
Preferential tax rate	Reduces tax rates on some forms of income.	Capital gains on certain income are subject to lower tax rates under the individual income tax.
Deferral	Delays recognition of income or accelerates some deductions otherwise attributable to future years.	Taxpayers may defer paying tax on interest earned on certain U.S. savings bonds until the bonds are redeemed.

Source: GAO-13-167SP: Guide for Evaluating Tax Expenditures.

In considering these six types of tax expenditures, it may be possible to achieve certain public policy outcomes in a variety of ways. For example, some public policy outcomes may be achieved through a preferential rate, a deduction, or a credit. Because a variety of approaches can produce the same cash effect, the types are different in form rather than substance.

Most reports do not categorize tax expenditures by type. The types are presented to aid in understanding the mechanisms used to establish preferences.

Budget Act Requirements and History

The term “tax expenditures” was introduced in 1967 by Assistant Secretary for Tax Policy, Stanley Surrey, in a speech calling for a “full accounting” of them. Following his speech, estimates were prepared by Treasury and later by the JCT of the Congress.

In 1974, the Budget Act charged the House and Senate Budget Committees with the duty “to request and evaluate continuing studies of tax expenditures, to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and to report the results of such studies to the Senate on a recurring basis.” The Budget Act further required that the annual President’s Budget include tax expenditure estimates.[10]

Estimates are now available annually from both the JCT[11] and the President’s Budget.[12] Each JCT report contains a discussion of the concept of tax expenditures, identification of new tax expenditures enacted into law, a general explanation on how the committee staff measures tax expenditures, estimates of tax expenditures, and distributions of selected individual tax expenditures by income class.

Treasury prepares estimates provided in the President’s Budget. These estimates are for the current fiscal year and the ten years thereafter. The estimates are intended to support budget analysis and are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in assessing the efficiency and effectiveness of achieving specific public goals through the use of tax expenditures. Treasury provides the tax expenditure estimates before the end of each fiscal year and makes them available on the Treasury website before the President’s Budget is issued.[13]

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[10] Kleinbard, Edward. Tax Expenditure Framework Legislation, *Research Paper Series and Legal Studies Research Paper Series, Paper No. C10-1.* USC Center in Law, Economics and Organization. 2010.

[11] See https://www.jct.gov/publications.html?func=select&id=5 for JCT Publications on Tax Expenditures. As of January 6, 2017, estimates for fiscal years 2015-2019 were available in report number JCX-141R-15.

[12] See https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf for the Fiscal Year 2017 President’s Budget. The Analytical Perspectives, Chapter 14 provides estimates for fiscal years 2015 through 2025. (Last accessed January 6, 2017.)

[13] See http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx for the latest estimates of tax expenditures. (Last accessed January 6, 2017.)

Government Performance Reporting for Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) originally put in place a framework for performance planning and reporting, and the GPRA Modernization Act of 2010 (GPRAMA) has significantly enhanced the statutory framework.[14] The GPRAMA framework aims at taking a more crosscutting and integrated approach to focusing on results and improving government performance. OMB is required to coordinate with agencies to establish federal government priority goals—otherwise referred to as cross-agency priority (CAP) goals.[15] GPRAMA requires certain agencies to identify a subset of agency goals as agency priority goals (APG), which reflect the highest priorities of each agency. Fully implementing GPRAMA requirements could provide the foundation for reviewing tax expenditure performance and assessing their contributions toward federal goals. GPRAMA requires OMB to identify tax expenditures that contribute to the CAP goals. In addition, OMB guidance has directed agencies to identify tax expenditures that contribute to their APGs since 2012 and to their strategic objectives since 2013.[16]

While OMB has determined that there are no tax expenditures that are critical to achievement of the current CAP goals, agencies have not yet completed actions necessary to identify tax expenditures that contribute to their APGs.[17]

How Treasury Prepares the Administration's Estimates

As noted in the definition above, tax expenditures arise from special provisions allowing an exclusion, exemption, or deduction from gross income, a credit, a preferential rate of tax, or a deferral of liability. Deciding whether a provision of tax law is a special exception to the baseline income tax system is a matter of judgment. The baseline used by Treasury to identify these special exceptions is adapted from a comprehensive income tax approach in which income is the sum of consumption and the change in net wealth in a given period of time with certain

[14] Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993) and Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

[15] OMB set the first interim CAP goals in 2012 and identified the next set of CAP goals in March 2014, which is to be updated every four years.

[16] OMB, Circular A-11 (2015).

[17] GAO, *Managing for Results: Implementation of GPRA Modernization Act Has Yielded Mixed Progress in Addressing Pressing Governance Challenges,* GAO-15-819 (Washington, D.C.: Sept. 28, 2015) and GAO, *OMB Improved Implementation of Cross-Agency Priority Goals, But Could Be More Transparent About Measuring Progress*, GAO-16-509 (Washington, D.C.: May 20, 2016).

departures.[18] This baseline assumes an individual income tax and a separate corporate income tax. [19]

Preparing tax expenditure estimates requires consideration of certain information about the economy, presently and in the future. Treasury estimates for economic activity are consistent with the economic assumptions in the President's Mid-Session Review of the prior year's budget and reflect current law as of July 1.[20]

Each tax expenditure is measured by the difference between tax liability under current law and the tax liability that would result if the tax expenditure provision were repealed and had never existed. It is assumed that there is no behavioral response to the elimination of the provision and taxpayers simply recalculate their tax in the absence of the provision in question. Thus, tax expenditures calculate revenues forgone by the existence of the rule but not necessarily the amount of revenue that would be raised if it were repealed. For example, the ability to deduct mortgage interest expense on owner-occupied housing is considered to be a tax expenditure. The tax expenditure estimate reports the revenue change that would occur if this deduction were repealed, but does not take into account any revenue effect that might occur as a result of most changes in taxpayer behavior, such as taxpayer decisions to own homes. However, in recalculating the tax due in the absence of this deduction, the tax expenditure estimate assumes taxpayers would switch from itemizing deductions to claiming the standard deduction if that were tax minimizing in the absence of the ability to deduct mortgage interest on an itemized return.

When possible, Treasury uses samples of tax returns provided by the Internal Revenue Service as the basis for tax expenditure estimates. For provisions benefiting individual tax filers the Individual Tax Model (ITM) Tax Calculator is often used. The ITM is based upon a stratified sample of individual tax returns that represent the entire tax filing population. This sample is augmented by additional data to represent the U.S. population. The ITM projects these individual records forward consistent with the Administration's economic forecast. The ITM Tax Calculator allows the computation of tax for each record under differing tax laws.

[18] For example, one major departure is that income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as a tax expenditure. Another example is that values of assets and debt are not generally adjusted for inflation.

[19] Treasury and the JCT differ in their assumed baselines from which tax expenditures are measured. For a summary of the differences see Altshuler, Rosanne and Robert Dietz. "Reconsidering Tax Expenditure Estimation." *The National Tax Journal*, June 2011, 64 (2, Part 2), 459-490.

[20] "Current law baseline" refers to the budget estimates prepared by the Administration based on laws enacted at the time they are prepared. If a provision will expire or change under currently enacted law then the baseline projections reflects the effects of that expiration or change.

For example, the Lifetime Learning tax credit is considered a tax expenditure because the baseline tax system would not allow credits targeted at particular activities, investments, or industries. Treasury uses the ITM Tax Calculator to compute tax liability for each filing unit under current law and current law with the Lifetime Learning tax credit removed.

As another example, the exclusion of public assistance benefits is considered a tax expenditure because transfers from the government would be considered income to the taxpayer under the baseline tax system. Since tax records do not record the receipt of these types of benefits, Treasury estimates the value of this tax expenditure by supplementing historical Bureau of Economic Analysis National Income and Product Accounts data with U.S. Department of Health and Human Services and state expenditure data to determine the total forecasted value of public assistance transfers to taxpayers under current law over the budget window. The tax expenditure is calculated by multiplying the aggregate public transfers by an estimate of the average effective tax rate for tax filers receiving public assistance benefits.

Treasury estimates the cash effect of each tax expenditure. Some tax expenditures represent deferrals of taxation (a tax not paid in the current tax year will be paid in a future tax year when the deferral reverses). Estimates for such deferrals are based on the net tax effect of current year deductions or exclusions and reversals of prior year deferrals included in current year taxable income.[21] For example, defined contribution employer plans are estimated as the net tax effect of current year contributions excluded from income and income reported upon withdrawals from plans.

Year-to-year differences in the calculations for each tax expenditure reflect changes in tax law, including phase outs of tax expenditure provisions and changes that alter the baseline income tax structure, such as the tax rate schedule, the personal exemption amount, the standard deduction, and other factors. For example, the dollar value of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law.

Understanding Estimates

Tax expenditure estimates are developed to aid policymakers. It is important to understand that they are not transaction-based amounts. The estimates are updated annually using the best available data and models. However, data limitations and resource constraints are inherent in the process. For example, some data collected on tax returns are not available in time for the annual estimates; other data are not collected on tax returns at all and must always be estimated.

[21] To complement these estimates, Treasury also reports a discounted present-value estimate of the future net revenue effects for the tax expenditure activity in the most recently concluded calendar year.

The major considerations regarding the estimates are identified below.

Not Necessarily Equivalent to Forgone Revenue. Estimates should be regarded as approximations. As with expenses incurred with spending programs, tax expenditure estimates do not necessarily equal the change in the deficit[22] that would result from repealing these special provisions because:

a. eliminating a tax expenditure may have incentive effects that alter economic behavior and

b. tax expenditures are interdependent even without incentive effects.

Difficulty in Calculating Totals. A total for the estimated tax expenditures is not provided in the President's Budget because each tax expenditure is estimated independently assuming other parts of the tax code remain unchanged. The estimates might be different if two or more tax expenditures were changed simultaneously because of potential interactions among provisions. Nonetheless, other experts do present a total summing the separate estimates. The Congressional Budget Office (CBO) has modeled the interaction of the ten largest tax expenditures in the individual income tax law and found that interactions that overstate the effect are similar in size to interactions that understate the effect.[23] As a result, CBO concluded that the total is a meaningful estimate for the general magnitude of tax expenditures under current tax law. If the law changes in significant ways the interactions may not result in offsetting over- and understatements of the effect to the same extent.

Completeness. As noted earlier, significant judgments are required to identify special provisions of the income tax code. Given the complexity of the tax code, differences in judgments lead some to include provisions in tax expenditure lists that others would exclude and vice versa. In addition, special provisions can be included in taxes other than income taxes (for example, excise taxes), but these generally are not included in reports on tax expenditures.

Expiring Provisions. Estimates are based on tax law enacted as of July 1 of the reporting year and assume that any provisions scheduled to expire will expire. As noted above, provisions likely to be extended are ignored for estimation purposes until

[22] Note that repealing certain spending programs would also not reduce the deficit by the amount of spending because of interaction with other programs and the tax system. For example, Social Security benefits may be taxed so that eliminating the benefits would also reduce tax revenue and possibly increase spending in other benefit programs. Thus, the change in the deficit would be smaller than the direct spending eliminated through the adjustment to the Social Security program.

[23] Congressional Budget Office. *The Distribution of Major Tax Expenditures in the Individual Tax System.* May 2013.

such legislation is actually enacted. In other words, estimates are based on current law rather than analyzing policy outcomes likely to occur. As a result, an extensive knowledge of tax policy may be required in order to understand multi-year tax expenditure projections when provisions are scheduled to expire or when provisions of previous legislation are phased in.

Alternatives. Estimates involve significant judgments and, as a result, there are alternative approaches to estimation. For example, alternatives regarding the application of marginal tax rates, treatment of related tax provisions, or selection of a different baseline (such as a consumption tax rather than an income tax) would affect tax expenditure estimates. In addition, while estimates are provided for the cash (current revenue) effect for each of the ten fiscal years covered by the projections, a present value alternative that considers the full life cycle of the taxable activity may be more useful for tax expenditures involving deferrals or other long-term revenue effects. For such tax expenditures, the present value effects are important because deferrals will reverse in later years, and a present-value estimate for the activity in the current calendar year would include this activity.

See http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx for a complete listing of tax expenditures reported and estimated by Treasury.

Appendix C: Task Force Members

R. Scott Bell	Department of the Treasury, Senior Accountant
Robert Bixby	The Concord Coalition, Executive Director
Robert Dietz	NAHB, Tax and Market Analysis, Senior Vice President
Bert Edwards	GWSCPA Federal Issues and Standards Committee (FISC) Member
Regina Kearney	Office of Management and Budget, Senior Advisor
John McClelland	Department of the Treasury, Office of Tax Analysis, Economist
James McTigue, Jr.	Government Accountability Office, Strategic Issues, Director
Tim Morgan	PricewaterhouseCoopers, Partner (retired)
Dan Murrin	EY, Partner; GWSCPA FISC Member
MaryLynn Sergent	Government Accountability Office, Strategic Issues, Assistant Director
Jamie Taber	Office of Management and Budget, Economist
Alexandra Thornton	Center for American Progress, Tax Policy, Senior Director
Robin Valentine	KPMG LLP, Partner
David Weiner	Congressional Budget Office, Tax Analysis Division, Assistant Director

Appendix D: Abbreviations

APG	Agency Priority Goals
CAP	Cross-Agency Priority
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
GPFFR	General Purpose Federal Financial Report
GPRA	Government Performance and Results Act of 1993
GPRAMA	GPRA Modernization Act of 2010
ITM	Individual Tax Model
JCT	Joint Committee on Taxation
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
OI	Other Information
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 53: Budget and Accrual Reconciliation: Amending SFFAS 7, and 24, and Rescinding SFFAS 22

Status

Issued	October 27, 2017
Effective Date	For periods beginning after September 30, 2018. Earlier implementation is permitted.
Affects	• SFFAS 7, par. 80, 81, 82, 91, 92, 93, 95, 96, 97, 98, 99, 100, 101 and 102. • SFFAS 22 is rescinded. • SFFAS 24, par. 9.
Affected by	None.

Summary

This Statement amends requirements for a reconciliation between budgetary and financial accounting information established by Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. To increase informational value and usefulness, and to support the government-wide financial statement reconciling net operating cost to the budget deficit, this Statement provides for the budget and accrual reconciliation (BAR) to replace the statement of financing. The BAR explains the relationship between the entity's net outlays on a budgetary basis and the net cost of operations during the reporting period.

The BAR will start with net cost of operations and be adjusted by

- components of net cost that are not part of net outlays,
- components of net outlays that are not part of net cost, and
- other temporary timing differences, which reflect some special adjustments.

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.

Table of Contents

Standards

Scope

1. This Statement applies when a component reporting entity is presenting general purpose financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board.* This information is not required in the consolidated financial report of the U.S. Government as a whole.

Amendments to SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (SFFAS 7)

2. Paragraphs 80 to 82 of SFFAS 7 established standards regarding a reconciliation and are replaced with the following paragraphs:

    80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different. To better understand these differences, the reconciliation should explain the relationship between the net cost of operations[1] and net outlays by the entity during the reporting period. The reconciliation should reference the reported "net outlays"[2] and related adjustments as defined by Office of Management and Budget (OMB) Circular A-11: *Preparation, Submission, and Execution of the Budget*.

    81. The net cost of operations should be adjusted by

[1]The terms "net cost of operations" and "net cost" are used interchangeably to refer to the total cost incurred by the reporting entity less exchange revenue earned during the period.

[2]OMB Circular A-11: *Preparation, Submission, and Execution of the Budget* states, “Outlay means a payment to liquidate an obligation (other than the repayment to the Treasury of debt principal). Outlays are a measure of Government spending. Subtract all offsetting collections (unexpired and expired) from gross outlays to yield net outlays so that the contribution of the budget account to the Federal Government's bottom line (the surplus or deficit) can be determined.”

a. components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);
b. components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and
c. other temporary timing differences (e.g., prior period adjustments due to correction of errors).

82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis amounts used in financial accounting. A narrative explaining the purpose, the nature, and the line items of the reconciliation also should be presented with the reconciliation. The amount and nature of non-cash outlays should be disclosed. For purposes of this Statement, non-cash outlays are outlays that are recognized without a concurrent cash disbursement, such as interest accrued by the Department of the Treasury (Treasury) on debt held by the public and the change in allowance for subsidy cost.

3. Paragraphs 91 to 93 of SFFAS 7 amended Statement of Federal Financial Accounting Concepts 2, *Entity and Display,* to address the then new reconciliation. To ensure SFFAC 2 aligns with the amended standards, these paragraphs are replaced with the following paragraphs:

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 and outlay-based measures used in budgetary reporting.

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 **Budget and Accrual Reconciliation** (BAR) that reconciles the net budgetary outlays 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 **Budget and Accrual Reconciliation** 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 (referencing the Reconciliation of Net Costs to Outlays) should be added stating the following:

> OMB will provide guidance regarding details of the display for the Budget and Accrual Reconciliation, including whether it should be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

4. The header before paragraph 95 of SFFAS 7 titled "Statement of Financing" is replaced with "Budget and Accrual Reconciliation."

5. Paragraphs 95 to 102 of SFFAS 7 amended SFFAC 2 to provide for the reconciliation. These paragraphs are amended to ensure the concepts and the related illustration (presented as Appendix 1-G of SFFAC 2) align with the amended standards. Paragraphs 95 to 102 and the related illustration are replaced with the following:

    95. The purpose of the reconciliation of Net Costs to Outlays is to explain how budgetary resources outlayed during the period relate to the net cost of operations for the reporting entity. This information should be presented in a way that clarifies the relationship between the outlays reported through budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship, the reconciliation provides the information necessary to understand how the budgetary outlays finance the net cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the reconciliation are indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from outlays to net cost of operations.

    96. **Net Cost of Operations** is from the Statement of Net Cost.

    97. **Components of net cost that are not part of net outlays** are most commonly (a) 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), (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period, and (c) costs financed by other entities (imputed inter-entity costs).

    98. **Components of net outlays that are not part of net cost** are primarily amounts provided in the current reporting period that fund costs incurred in prior years and amounts incurred for goods or services that have been capitalized on the balance sheet (e.g., plant, property and equipment acquisition and inventory acquisition).

    99. **Other temporary timing differences** reflect special adjustments (e.g., prior period adjustments due to correction of errors).

100. **Net Outlays** is the summation of the above amounts and equals the Statement of Budgetary Resources net outlays amount.

101. The preparer should present material amounts separately in the reconciliation and discuss these in the narrative. The use of "other" captions should be minimized and individually material amounts should not be netted to report an immaterial amount.

102. The following is an example for the financial statement format. This format and its narrative will be added to the appendices of SFFAC No. 2.

Entity and Display, Appendix 1-G

EXAMPLE FINANCIAL STATEMENT FORMATS - BUDGET AND ACCURAL RECONCILIAITON

NARRATIVE

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis below illustrates this reconciliation by listing the key differences between net cost and net outlays.

*Unrealized valuation loss on investment in the reconciliation is related to the write down of security investment due to recent market volatility, which did not result in an outlay but did result in a cost. The large increase of accounts payable compared to last year is because this year's rent expense has not been paid but was included in the net cost this year and not included in the outlays. The large variance in the "transfers in/(out) without reimbursement" between fiscal year (FY) 201X and FY201X is primarily due to the transfer of program management responsibility from agency 1 to agency 2 as discussed in further detail in Note X. In addition, the decrease in "Imputed financing source" is a result of the payment in FY201X for the ABC Settlement.**

* This is an illustration of what might be presented in the narrative paragraph. It is an example of how to explain the material line items in the reconciliation and describes why some material line items either increase or decrease net cost but do not have the same impact on net outlays.

RECONCILIATION EXAMPLE- For the year ended September 30, 201X

	Intra-governmental	With the public	Total FY 201x
NET COST	**$xxx**	**$xxx**	**$xxx**
Components of Net Cost That Are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	xxx	xxx	xxx
Property, plant, and equipment disposal & revaluation	xxx	xxx	xxx
Year-end credit reform subsidy re-estimates	xxx	xxx	xxx
Unrealized valuation loss/(gain) on investments	xxx	xxx	xxx
Increase/(decrease) in assets:			
Accounts receivable	xxx	xxx	xxx
Loans receivable	xxx	xxx	xxx
Investments	xxx	xxx	xxx
Other assets	xxx	xxx	xxx
(Increase)/decrease in liabilities:			
Accounts payable	xxx	xxx	xxx
Salaries and benefits	xxx	xxx	xxx
Insurance and guarantee program liabilities	xxx	xxx	xxx
Environmental and disposal liabilities	xxx	xxx	xxx
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	xxx	xxx	xxx
Other financing sources:			
Federal employee retirement benefit costs paid by OPM and imputed to the agency	xxx	xxx	xxx
Transfers out (in) without reimbursement	xxx	xxx	xxx
Other imputed financing --	xxx	xxx	xxx
Total Components of Net Cost That Are Not Part of Net Outlays	**xxx**	**xxx**	**xxx**
Components of Net Outlays That Are Not Part of Net Cost:			
Effect of prior year agencies credit reform subsidy re-estimates	xxx	xxx	xxx
Acquisition of capital assets	xxx	xxx	xxx

	Intra-governmental	With the public	Total FY 201x
Acquisition of inventory	xxx	xxx	xxx
Acquisition of other assets	xxx	xxx	xxx
Other	xxx	xxx	xxx
Total Components of Net Outlays That Are Not Part of Net Cost	**xxx**	**xxx**	**xxx**
Other Temporary Timing Differences	**xxx**	**xxx**	**xxx**
NET OUTLAYS	**$xxx**	**$xxx**	**$xxx**[3]

Rescission of SFFAS 22, *Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations,* Amendment of SFFAS 7, *Accounting for Revenue and Other Financing*

6. SFFAS 22 is rescinded in its entirety by this Statement.

Amendment to SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*

7. The following paragraph replaces SFFAS 24, paragraph 9:

   9. Paragraphs 77-82 of SFFAS 7 are not applicable to the consolidated financial report of the U.S. Government as a whole.1 [Text of footnote 1: Footnote rescinded by SFFAS 53.]

Effective Date

8. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Early adoption is permitted. In the initial year of implementation, the

[3] Total Net Outlays can be linked to the Statement of Budgetary Resources, and equals gross outlays less actual offsetting collections and distributed offsetting receipts. The net outlays for Intra-governmental and With the Public listed in the format are calculated totals.

disclosure requirements that were applicable in prior reporting periods (SFFAS 7 (unamended) paragraphs 80 to 82) are not required for comparative presentations.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. The Statement of Financing (SOF) note disclosure has been criticized as too complex and not useful. In July 2012, the Association of Government Accountants' research report (titled Government-wide Financial Reporting) suggested improvements in the processes used to prepare the consolidated financial report, as well as related standards. Moreover, the consolidated financial report of the U.S. Government (CFR) includes a basic financial statement reconciling the Unified Budget Deficit (deficit) and the Net Cost of Operations. The deficit is based on receipts and outlays rather than obligations. The current component reporting entity obligation-based SOF reconciliation does not align with the CFR reconciliation.

A2. In February 2016, the Board agreed to undertake a project to assess the SOF and formed a Budget and Accrual Reconciliation (BAR) task force. Through this project, the Board planned to address concerns regarding the reconciliation and the need to support the CFR reconciliation by aligning the component reporting entity disclosures with the CFR requirements. In addition to agreeing with the concerns of the Board, the BAR task force identified the following topics to be addressed:

a. The complexity and usefulness of the SOF note

b. Ways to more directly relate budgetary data and accrual data for a less complex presentation

c. Support for the CFR reconciliation statement (limited to component reporting entity requirements)

A3. The BAR task force, which included industry representatives from several public accounting and consulting firms, as well as representatives with financial reporting preparation and policy background from the following federal agencies, supported the development of this proposed Statement:

a. Department of Energy (DOE)

b. Treasury

c. Department of Veterans Affairs (VA)

d. Small Business Administration (SBA)

e. U.S. Coast Guard (USCG)

f. Securities and Exchange Commission (SEC)

A4. During the initial phase of the project, the BAR task force was divided into subgroups to research (a) the usefulness of the current SOF, (b) a new component reporting entity reconciliation format, and (c) the potential amendment to the existing standards to adopt the new reconciliation format. The SOF sub-group reviewed 23 major agencies' current SOF notes to understand their current SOF note preparation process and surveyed task force members on the advantages and disadvantages of the current SOF note. Based on the research result, the task force came to the following conclusions:

a. Each agency established its own processes.

b. The SOF is time consuming to prepare.

c. Without government-wide guidance, the SOF note is not comparable between agencies.

d. The SOF note is too complex to be useful.

A5. Subsequently, the BAR task force researched and developed a first draft of the BAR format based on the objectives identified. In addition, the BAR subgroups (a) performed agency-level piloting of the BAR, (b) researched detailed account level guidance needed to support the BAR, (c) aligned the current format to the related CFR format, and (d) conducted other research including consideration of changes to the existing standards.

A6. In June 2016, the Board approved the BAR task force's recommendations based on its research results. These recommendations included the following:

a. The current SOF note should be replaced due to its complexity and limited usefulness.

b. There is a need to develop an alternative presentation format that would better relate budgetary and accrual data, as well as support the CFR reconciliation.

A7. By the end of July 2016, the task force proposed an updated BAR. Six agencies--DOE, SBA, SEC, Treasury, USCG, and VA-piloted the BAR and provided their feedback on the pilot process and how the updated BAR compares to the current SOF note. Based on the pilot results, the BAR task force identified many advantages and some disadvantages of replacing the SOF note with a reconciliation of net cost to net outlays.

A8. In August 2016, the Board tentatively approved the new format and supported continued development efforts, including involving more agencies to pilot the BAR. By the end of this project phase, a total of 13 agencies-including 11 cabinet agencies-joined the pilot efforts.

A9. Based on feedback from the task force and pilot agencies, the new BAR

a. supports the CFR reconciliation,

b. is easier to prepare than the current SOF note disclosure,

c. is easier for users not familiar with federal budgeting and accounting to understand due to its similarity to the commercial cash flow statement, and

d. requires that each agency develop a new process to support the development of the new BAR.

A10. The task force developed detailed account level guidance for each line item of the BAR and compared it to the information needed to support the CFR budget deficit and net cost reconciliation. The task force found that a majority of the current CFR reconciliation line items will be supported by the new reconciliation. The remaining line items primarily relate to budget receipts, which were intentionally omitted in the new reconciliation to simplify the presentation and reduce the preparation burden on the component reporting entities.

A11. According to the task force respondents, the new reconciliation is an improvement in comparison to the existing reconciliation. The BAR is more closely aligned with information presented in component reporting entity financial statements. It is easier to understand, and readily auditable. Further, the requirement to provide a narrative explanation of the reconciliation and significant reconciling items also enhances its understandability. For most agencies, it does not require a change of the agencies' current software.

A12. Treasury has collaborated with the task force representatives in developing guidance that could be used to prepare the BAR. Such guidance will facilitate implementation and reduce costs.

Summary of Outreach Efforts and Responses

A13. The Board issued the exposure draft (ED), *Budget and Accrual Reconciliation*, on December 21, 2016, with comments requested by March 14, 2017.

A14. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, FASAB News, the *Journal of Accountancy*, Association of Government Accountants Topics, the CPA *Journal, Government Executive*, the *CPA Letter*, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A15. FASAB received 27 responses from preparers, users of federal financial information, and professional associations. The majority of respondents agreed with the proposals to (1) replace the SOF with the BAR, (2) present the BAR as a footnote, and (3) present a narrative disclosure accompanying the BAR.

A16. Approximately half of the respondents disagreed with the proposed effective date and the proposal for the restatement of comparative prior period information. Nine out of 27 respondents also disagreed with the proposal to have a breakdown of the Intragovernmental and With the Public in the reconciliation.

A17. Some respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A18. The Board did 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 considered each response and weighed the merits of the points raised. The respondents' significant comments are summarized below.

A19. Some respondents disagreed with the proposed effective date because they believed it did not allow them sufficient time to test the new format. To maximize agency success in adopting the proposed Statement and allow each agency sufficient time testing the new process, the Board agreed to change the effective date to periods beginning after September 30, 2018, with early adoption permitted.

A20. Some respondents stated that to restate prior period data, a one-year phase-in period would be needed. During this time, comparative data could be collected and reported while agencies continued to provide the SOF. Most of the respondents believed that a change to the BAR format should be done prospectively. The Board considered that the restatement of the prior period data does not add any additional value, and the prior year SOF would not be comparable with the BAR format during the implementation year. Ultimately, the Board agreed to present only data for one reporting period in the first year of implementation, with a comparative presentation in the following reporting period.

A21. The agencies listed various reasons or challenges that they would face, should agencies be required to present separately in the BAR Intragovernmental and With the Public data. For example, while the BAR reconciles line items from the Statement of Net Cost and Statement of Budgetary Resources, only the Statement of Net Cost provides information needed to distinguish between amounts that are Intragovernmental as opposed to With the Public. That distinction is not made regarding amounts, including outlays, shown on the Statement of Budgetary Resources. A few agencies also stated that outlays by trading partner are not readily available in their current systems, and agencies are concerned about the additional system investment cost and the labor-intensive work to segregate information for certain line items associated with this breakdown request.

A22. Treasury has stated it needs the audited breakdown of Intragovernmental and With the Public to support the elimination process during consolidation. Without the breakdown, the BAR format is less beneficial for the CFR reconciliation because intragovernmental amounts will not be identified for elimination.

A23. After carefully considering the comments received on the breakdown, the Board proposed an updated BAR format without the breakdown of the budgetary net outlays. However, the format retains the breakdown of line items above the net outlays based on the following:

a. Although the BAR format is illustrated in the Statement, this Statement does not explicitly require this breakdown. The Office of Management and Budget (OMB) and Treasury have the option to establish more or less detailed requirements upon implementation or in the future.

b. In the proposed BAR format, the line items for the section "Components of Net Cost That Are Not Part of Net Outlays" are taken directly from the Balance Sheet and the Statement of Net Cost. The needed breakdowns already exist in those statements. The majority of the individual line items for the section "Components of Net Outlays That Are Not Part of Net Cost" can be supported by USSGL for the breakdown.

A24. To ensure the updated BAR format reasonably addressed agency concerns before finalizing this Statement, Treasury updated the detailed account level guidance with a breakdown of Intragovernmental and With the Public. The updated format and guidance were provided to the nine agencies expressing concerns about the breakdown during the comment period. Six of the nine agencies responded after piloting both the format and the guidance, and they all preferred this updated format. Based on the positive feedback from those respondents, the revised format is included as an illustration to be presented in SFFAC 2 as amended by this Statement.

A25. The Board believes disclosing information about any non-cash outlays would aid in preparing the CFR reconciliation of the budget surplus (deficit) to the change in cash.

Board Approval

A26. This Statement was approved for issuance by all members of the Board.

Appendix B: Abbreviations

BAR	Budget and Accrual Reconciliation
CFR	Consolidated Financial Report of the U.S. Government
DOE	Department of Energy
FASAB	Federal Accounting Standards Advisory Board
FECA	Federal Employees' Compensation Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget
OPM	Office of Personnel Management
SBA	Small Business Administration
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOF	Statement of Financing
Treasury	Department of the Treasury
USCG	United States Coast Guard
VA	Department of Veterans Affairs

Statement of Federal Financial Accounting Standards 54: Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment

Status

Issued	April 17, 2018
Effective Date	For periods beginning after September 30, 2023. Earlier adoption is not permitted.
Affects	• SFFAS 5, par. 43 - 46 are rescinded • SFFAS 6 par. 20 and 29 are rescinded
Affected by	None.

Summary

This Statement revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases.

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.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. For purposes of applying this Statement, a **lease**[1] is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E)[2] (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.

3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, a federal entity should assess whether the contract or agreement gives the lessee both of the following:

    a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement

    b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement

4. The lease definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par.73). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[2] SFFAS 6, *Accounting for Property, Plant, and Equipment*.

5. This Statement does not apply to

   a. leases of assets under construction or

   b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

Definitions

> Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.

8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*[3] whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

[3]SFFAS 47, Reporting Entity, par. 38–42.

11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

Lease Term

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of

    a. the period identified in the lease contract or agreement that precedes any option to extend the lease or

    b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.

15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:

    a Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option

    b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option

    c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option

d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option

16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:

    a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option

    b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option

    c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option

    d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option

18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.

19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:

a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore, either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.[4]

b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.

c. An availability of funds or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraph 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates

b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)

c. The history of exercising options to extend or terminate

[4] SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

d. The extent to which the asset underlying the lease is mission critical to the federal entity

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

    a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17

    b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17

    c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

Short-Term Leases

22. A short-term lease is a lease with a lease term (as defined in paragraphs 14 - 21) of 24 months or less.

Lessee Treatment of Short-Term Leases

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

Lessor Treatment of Short-Term Leases

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

Contracts or Agreements that Transfer Ownership

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14–19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par.19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.[5]

Intragovernmental Leases

26. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting and disclosure guidance described in paragraphs 27–38.

27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

29. Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.

[5]SFFAS 6, *Accounting for Property, Plant, and Equipment*, par. 26.

30. Rental increases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation (tied to a specific economic indicator where the specific amount of the change is not known).

31. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase.

32. Lease incentives should be recognized by the lessee as deferred revenue when received from the lessor and then as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term, and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.

33. Lease concessions should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.

34. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.

35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor’s accounting for PP&E.[6]

36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

Disclosures for Intragovernmental Leases

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

[6]This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, *Accounting for Property, Plant and Equipment,* par. 37.

a. A general description of significant intragovernmental leasing arrangements, including general lease terms with any applicable specific intragovernmental requirements

b. Annual lease expense in total and by major leased PP&E category.

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

a. A general description of significant leases, including a breakdown of the number of leases with federally-owned assets and privately-owned assets

b. Future lease payments that are to be received to the end of the lease term for each of the five subsequent fiscal years and in five-year increments thereafter

Lessee Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases

39. At the commencement of the lease term, a lessee should recognize a lease liability and a PP&E right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraph 26–38 (intragovernmental leases).

Lease Liability

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

a. Fixed payments

b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

c. Variable payments that are fixed in-substance as described in paragraph 41

d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees

e. The exercise price of a purchase option if it is probable that the lessee will exercise that option

f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause

g. Any lease incentives (par. 70–71) receivable from the lessor

h. Any other payments to the lessor that are probable of being required based on an assessment of all relevant factors

41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.

42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**[7] (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

[7] A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes[8] have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and if the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:

    a. There is a change in the lease term.

    b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable or vice versa.

    c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

    d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).

    e. There is a change in the interest rate the lessor charges the lessee if used as the initial **discount rate**.

    f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.

45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

46. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:

[8] Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

a. There is a change in the lease term.

b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.

48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

Lease Asset

49. A lessee should initially measure the lease asset as the sum of the following:

a. The amount of the initial measurement of the lease liability (par. 40)

b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 70–71)

c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.

51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

52. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraph 44–48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

53. Leased assets classified as PP&E are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The change in the manner or duration of use of the underlying asset is an indicator that the right of use asset may be

impaired (SFFAS 44, par. 12). If the underlying asset is impaired, it should be reduced first for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.[9]

Component Reporting Entity Disclosure Requirements for Lessees

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

    a. A general description of its leasing arrangements, including:

        i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

        ii. the existence, terms, and conditions of residual value guarantees provided by the lessee

    b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from other PP&E assets

    c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability

    d. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

Lessor Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmenal Leases

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38

[9] SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use,* par. 18–25.

(intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

Lease receivable

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:

    a Fixed payments

    b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

    c. Variable lease payments that are fixed in-substance as described in paragraph 57

    d. Residual value guarantees that are fixed payments in substance (par. 57)

    e. Any lease incentives (par. 70–71) payable to the lessee

57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not

required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.

60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes,[10] and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:

    a. There is a change in the lease term.

    b. There is a change in the interest rate the lessor charges the lessee.

    c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

62. If a lease receivable is remeasured for any of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

63. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable:

    a. There is a change in the lease term.

[10] Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

b. There is a change in the interest rate the lessor charges the lessee.

Deferred Revenue

64. A lessor initially should measure the deferred revenue to include the following:

    a. The amount of the initial measurement of the lease receivable (par. 56)

    b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 70–71) paid to, or on behalf of, the lessee at or before the commencement of the lease term

65. A lessor subsequently should recognize the deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63.

Underlying Asset

66. A lessor should not derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

Component Reporting Entity Disclosures for Lessors

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

    a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined

    b. The carrying amount of assets on lease by major classes of assets, and the amount of related accumulated depreciation

    c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases

d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

Financial Report of the U.S. Government Disclosures

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

    a. A general description of its leasing arrangements

    b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets

    c. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    d. A general reference to relevant component reporting entity reports

Lease Incentives and Lease Concessions

70. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee, for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive

and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40–48) and by lessors consistently with the lessor's lease receivable (par. 56–63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.

Contracts or Agreements with Multiple Components

72. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

73. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.

74. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 76.

75. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on the terms of the contract or agreement and professional judgment, maximizing the use of observable information, for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual

component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.

76. If a contract or agreement does not include prices for individual components or if any of those prices appear to be unreasonable as provided in paragraph 75, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.

77. If multiple components are accounted for as a single lease unit as provided for in paragraph 76 , the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

Contract or Agreement Combinations

78. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:

    a. The contracts or agreements are negotiated as a package with a single objective.

    b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.

79. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 72–77.

Lease Terminations and Modifications

80. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast,

exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

Lease Terminations

81. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

Lessee Treatment of Lease Terminations

82. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

Lessor Treatment of Lease Terminations

83. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

Lease Modifications

84. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:

    a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.

    b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

Lessee Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

Lessor Treatment of Lease Modifications

86. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

Subleases

87. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

88. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

Sale-Leaseback Transactions

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale[11] to be eligible for sale-leaseback accounting. A sale-

[11] See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* par. 295.

leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

90. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the statement of net cost in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

91. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.

92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 54). A buyer-lessor should provide the disclosures required of a lessor (par. 67).

Lease-Leaseback Transactions

93. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

Amendments to SFFAS 5, *Accounting for Liabilities of the Federal Government,* and SFFAS 6, *Accounting for Property, Plant, and Equipment*

94. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 43–46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

[43.] ~~Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~The lease contains an option to purchase the leased property at a bargain price.~~
- ~~The lease term is e-qual to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

[44.] ~~The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote 20: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

[45.] ~~The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

[46.] ~~During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the~~

~~measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, “Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs,” provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.]~~

95. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: *Accounting for Property, Plant, and Equipment*

[20.] ~~Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.~~

~~[footnote 22: “Operating leases” of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]~~

- ~~The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~The lease contains an option to purchase the leased property at a bargain price.~~
- ~~The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: “Estimated economic life of leased property” is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.~~
- ~~The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: “Fair value” is the price for which an asset could be bought or sold in an arm’s-length transaction between unrelated parties~~

~~(e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.~~

[29.] ~~The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).~~

Implementation

96. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

    a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

    b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

97. The following implementation guidance addresses specific leasing circumstances.

    a. Prospective Implementation – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.

    b. Lease Term – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.

c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22–24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

Effective Date

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment."

Project History

A1. This Statement amends the lease accounting standards in SFFAS 5 and 6, which had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.

A2. The Federal Accounting Standards Advisory Board (FASAB or "the Board") undertook this project primarily because SFFAS 5 and 6

a. do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions and

b. are based on Financial Accounting Standards Board (FASB) lease accounting standards, which have been amended.

A3. Lease accounting was first addressed by FASAB during the development of SFFAS 5 and 6. At that time, the Board decided to use the high-level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) – Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.

A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically addressed in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to reduce confusion on whether FASB standards apply to federal entities when FASAB's are silent on a topic.

A5. Because FASB revised its standards, it was imperative for the Board to revisit lease accounting. One alternative was for the Board to issue detailed implementation guidance on the existing standards. The Board believed that the effort needed to issue such implementation guidance would be better used amending SFFAS 5 and 6. The Board closely reviewed the lease proposals of four standards setters (as stated in paragraph A8) to determine what underlying concepts, if any, would be applicable for federal financial reporting of leases. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.

A6. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.

A7. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the exposure draft (ED) preceding this Statement.

A8. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:

a. FASB's SFAS 13, *Accounting for Leases* [superseded by FASB's ASC 840, which was subsequently superseded by ASC 842]

b. Governmental Accounting Standards Board's (GASB) Statement No. 87, *Leases*

c. International Accounting Standards Board's International Accounting Standard 17, *Leases* [superseded by International Financial Reporting Standard 16]

d. International Public Sector Accounting Standards Board's International Public Sector Accounting Standard 13, *Leases*

A9. At the inception of the project, the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of this Statement. In 2014, FASAB and GASB met to discuss issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.[12]

A10. This Statement amends the lease accounting standards in SFFAS 5 and SFFAS 6. This Statement also establishes distinct standards for intragovernmental leases.

Summary of Outreach Efforts and Responses

A11. FASAB issued the ED, titled *Leases,* on September 26, 2016, with comments requested by January 6, 2017. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A12. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Committee on Oversight and Government Reform

b. House Committee on Transportation

c. House Committee on Budget

d. Senate Committee on Homeland Security and Governmental Affairs

e. Senate Committee on Budget

f. Senate Committee on Environment and Public Works

A13. FASAB received 25 responses from preparers, auditors, professional associations, and citizens. Many respondents had concerns with the definition of leases and the scope of the Statement. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

[12] The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

A14. The Board extended an invitation to the respondents of the Leases ED to discuss with the Board their comments on the ED and provide further clarification on their responses. In April 2017, five federal entities addressed the Board to further elaborate on their written comments.

A15. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

Considerations Related to Benefits and Costs

A16. Throughout the course of developing this Statement, the Board sought to minimize the cost of improving the lease accounting requirements. The Board's assessment of the expected benefits and perceived costs of issuing new standards is often more qualitative than quantitative because it is difficult to accurately estimate the costs of implementing new standards. The Board has made its assessments based on the available evidence of expected benefits and perceived costs with the goal of a balance between maximizing benefits and minimizing costs.

Benefits

A17. This Statement will improve upon the existing guidance in SFFAS 5 and 6 by providing

a. relevant and meaningful financial information needed by federal financial statement users and

b. comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

A18. One of the primary objectives of this Statement is providing federal leasing information needed to meet the operating performance reporting objective.[13] Recognition of all PP&E leases, except for short-term leases and intragovernmental leases, and the related liabilities ensures the balance sheet informs users regarding the resources and obligations used to fulfill the entity's programs and activities. Additionally, this Statement requires the recognition of the interest cost associated with the entity's leases. This will ensure relevant

[13] SFFAC 1 establishes the operating performance objective and indicates that 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.

and comparable information is available to assess the entity's operating performance as well as to monitor the entity's investment in PP&E and financing activities.

A19. The Board is aware that this Statement will require entities to ensure all of their leases are appropriately identified for evaluation, which can improve accountability of its resources and obligations. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Accounting*, accounting can and should contribute to achieving and demonstrating several aspects of accountability, such as

a. accountability for financial resources;

b. accountability for faithful compliance or adherence to legal requirements and administrative policies;

c. accountability for efficiency and economy in operations; and

d. accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness

This Statement contributes to each of these aspects of accountability but is most helpful in achieving accountability for efficiency and economy in operations. By removing somewhat arbitrary and bright-line (rules-based) criteria, a more complete and representationally faithful reporting of PP&E, liabilities, and costs will be provided as discussed in paragraph A21.

A20. The Board believes that in a lease transaction, a lessee receives the right to control the use of another entity's PP&E (the underlying asset—the asset that is subject to the lease, such as a vehicle or building) for a period of time as specified in the contract or agreement. In exchange, the lessee promises to make payments over time for the right to control the use of that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because they often resulted in similar leases being accounted for in different ways; making it challenging to identify the total resources needed to support operations and the related obligations.

A21. The Board believes that this Statement increases the comparability among federal entities by recognizing those similar leases as lease assets and lease liabilities and disclosing key leasing information. This approach would replace bright-line distinctions between capital and operating leases. The increased comparability will allow financial report users to make lease liability and interest cost comparisons among federal entities. This Statement also provides a clear definition of a lease that is intended to align with the concept of control established in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. The Board believes that this lease definition will reduce opportunities for entities to structure leasing transactions to achieve a specific accounting outcome. Such opportunities could result in misstated PP&E resources, related obligations, and costs.

Costs

A22. The Board understands that many federal entities—particularly those having a significant number of long-term leases with non-federal entities—will incur additional costs as a result of this Statement. Based on feedback from the task force and ED responses, the initial costs to implement the revised standards will most likely result from reviewing existing lease agreements, ensuring all leases are appropriately identified, educating staff about how to apply the new requirements, implementing processes and controls to ensure all material leasing activity is captured going forward, and some system changes. Those costs will vary based on the number of leases that an entity has and the complexity of those arrangements. For example, it may take more effort to account for a lease agreement with options to extend and multiple components than a lease without those elements.

A23. Respondent comments related to costs and benefits raised concerns about the overall effort and resources needed to implement the proposed guidance. Some respondents also raised concerns regarding limited resources to assess a significant volume of leases. Overall, the evaluation and analysis needed to implement this Statement is similar to the capital leases evaluation and analysis needed in SFFAS 5 and 6, which should help mitigate some of the costs of implementation.

A24. Once implementation of the Statement is complete, the ongoing costs for many entities are unlikely to be significantly higher than the costs of complying with the previous standards. In the previous leases standards, entities were also required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including the ongoing disclosure requirements. This Statement does not substantially change this level of effort and entities may be able to apply the requirements of this Statement using similar systems and processes as those used in previous leases standards to meet those reporting and disclosure requirements.

A25. Additionally, the Board made several decisions in the interest of reducing implementation costs. These include, but are not limited to, the provisions regarding:

a. Allowing a short-term lease exception and not requiring disclosures related to short-term leases by either lessees or lessors

b. Not requiring a lessor to derecognize the underlying asset or calculate a residual value

c. Allocation of the contract price to multiple components of a lease that allows the stated contract prices to be used if they do not appear to be unreasonable

d. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if stated prices appear to be unreasonable

e. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable

f. The exclusion of intragovernmental leases from balance sheet recognition and measurement as a lease asset and corresponding liability

g. The extension of the effective date until fiscal year 2021 which allows more time to prepare and reduces the number of existing leases to be evaluated

A26. For many federal entities, the Board's decisions relating to intragovernmental leases will reduce the preparer's level of effort in comparison to the current lease accounting and financial reporting standards. The majority of federal entities engage primarily in intragovernmental leases. Consistent simplified treatment of intragovernmental leases will also reduce the cost of intragovernmental eliminations. These cost reductions were considered carefully by the Board.

A27. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. The Board concluded that this approach to transition, as opposed to a retrospective approach, provides an appropriate balance between minimizing costs of transition and providing users of financial statements with comparable financial information. This implementation approach should further significantly reduce the costs associated with transitioning to the new lease requirements.

Scope

A28. For purposes of applying this Statement, a lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. Service contracts include maintenance of equipment or real property, advisory services, communications services, transportation services, and research and development.

A29. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

A30. GASB's Leases Statement No. 87 specifically excludes "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently, FASAB standards are silent on SCAs. Through its discussions, the task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from this Statement. To accomplish this, the Board considered adopting GASB's definition of SCA from Statement No. 60 because there is no federal definition.

A31. The Board eventually decided that specifically excluding SCAs from the standards would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project; therefore, the Board agreed to remain silent on SCAs in this Statement until such guidance is issued. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

Definitions

A32. In this Statement, a lease is defined as "a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration." In the early stages of the project, the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered GASB's approach—where the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, although legal enforceability is a primary driver for the non-intragovernmental leases, the Board decided to add "agreement" in addition to "contract" in the lease definition to alleviate ambiguity in its application. This should be especially relevant in the case of intragovernmental leases, which are often referred to as "lease agreements."

A33. The Board also reconsidered the broad scope of the lease definition, which included all nonfinancial assets not specifically excluded in the standards. During deliberations after receiving comment letters, the Board determined that the broader lease definition would necessitate the development of a definition of “nonmonetary assets” and “intangibles,” plus the inclusion of a more developed list of excluded transactions. Also, several respondents and task force members advocated a more narrow definition of leases. In an effort to reduce preparer burden, the Board reconsidered its decision and reevaluated the benefits of a narrower lease definition. The Board decided to narrow the scope of the definition to only include PP&E.

Lease Term – Options to Extend or Terminate

A34. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and the availability of funds, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but it should include certain options to extend or terminate so that the lease term reflects how long the lease is expected to be in effect.

A35. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB’s definition of probable, and FASB’s probability threshold “reasonably certain.” FASAB’s probable definition equates to more likely than not (>50% probability). GASB’s probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB’s reasonably certain probability has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly understood with the federal reporting community and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

A36. During deliberations after receiving comment letters, the Board considered additional ways to reduce the preparer’s burden and agreed on the following points:

a. The “noncancelable period” language should be clarified.

b. Both the lessee and the lessor’s options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.

c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold; however, when the lessee or lessor is assessing the other party’s options to extend or terminate the contract or agreement, the level of probability is at a higher threshold, like reasonably certain, and should be based on significant evidence.

Remeasurement

A37. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

Short-Term Leases

A38. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the short-term lease exception with the PP&E standards, which define PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize those leases with useful lives or maturities of less than two years as expense and revenue based on the payment provisions of those lease contracts or agreements and those standards regarding recognition of accruals. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

Intragovernmental Leases

A39. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A40. This Statement provides the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

A41. The terms “intragovernmental” and “inter-entity” have been used interchangeably. Earlier FASAB standards predominately used “inter-entity.” However, government-wide usage of “intragovernmental” has become more common; therefore, the Board used intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases

Recognition and Measurement for Lessees – Lease Liability

A42 SFFAC 5, defines a liability as a “present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.” The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.

A43. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

Recognition and Measurement for Lessees – Lease Asset

A44. An asset is defined in SFFAC 5 as “a resource that embodies economic benefits or services that the federal government controls.” Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to control the use of another entity’s PP&E (the underlying asset), and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

Recognition and Measurement for Lessors

A45. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the shared transaction in a way that mirrors how the other party accounts for it.

A46. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to control the use of the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

Board Approval

A47. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

Appendix B: Abbreviations

ASC	Accounting Standards Codification
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GASB	Governmental Accounting Standards Board
GSA	General Services Administration
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 55: Amending Inter-entity Cost Provisions

Status

Issued	May 31, 2018
Effective Date	For periods beginning after September 30, 2018. Earlier implementation is permitted.
Affects	• SFFAS 4, paragraphs 110, 111, and 113A are amended. • SFFAS 30 is rescinded. • Interpretation 6 is rescinded.
Affected by	None.
Related Guidance	TR 8, *Clarification of Standards Relating to Inter-Entity Costs*

Summary

Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts (including Interpretation 6, Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4)*, required reporting entities to recognize the full costs of services received from other federal reporting entities even if there was no requirement to reimburse the providing reporting entity for the full cost of such services.

This Statement revises SFFAS 4 to provide for the continued recognition of significant inter-entity costs by business-type activities and rescinds the following:

a. SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*[1]

b. Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*

With the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, as amended, are restored to their original language prior to the issuance of SFFAS 30. However, the Federal Accounting Standards Advisory Board adjusted the standards to require business-type activities to recognize inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget. Notwithstanding the absence of a requirement, non-business-type activities may

[1]Conforming amendments will be made to Technical Release 8, *Clarification of Standards Relating to Inter-Entity Costs*, to acknowledge the rescission of SFFAS 30.

elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

Materiality

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.

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Table of Contents

Standards

Scope

1. This Statement applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Rescission of SFFAS 30, *Inter-entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*

2. This paragraph rescinds SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts,* in its entirety. In doing so, this removes the broad requirement to recognize certain inter-entity costs.

Amendments to SFFAS 4, *Managerial Cost Accounting Standards and Concepts*

3. With the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, are restored to their original language prior to the issuance of SFFAS 30.

4. This paragraph amends[2] SFFAS 4, paragraphs 110 and 111 by

    a. revising the subtitle for this section and moving it before paragraph 110

    b. revising the paragraphs to provide for recognition of inter-entity costs by business-type activities and recognition of inter-entity costs for non-business type activities that elect to do so and

[2]The amendments are shown with strikethrough deletions of existing text and underlined additions.

c. providing for other minor updates.

Recognition

110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by ~~the various~~ federal entities. ~~Therefore, t~~ The Office of Management and Budget, ~~with assistance from the FASAB staff, should~~ may issue guidance identifying ~~the specific~~ additional inter-entity costs ~~for~~ entities ~~to~~ should recognize. ~~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 in paragraphs 111 through 113 ~~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.~~

~~Recognition Criteria~~

111. Recognition of ~~Ideally~~, all significant inter-entity costs ~~should be recognized~~. ~~This~~ is ~~especially~~ important when those costs constitute inputs to government goods or services provided ~~to non-federal entities~~ for a fee or user charge. Generally, ~~T~~the fees and user charges should recover the full costs of those goods and services. [Footnote 33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold ~~outside~~ by the federal government. Recognition of inter-entity costs supporting business-type activities [Footnote 33A] and recognition of inter-entity costs for non-business type activities that elect to do so ~~Such recognition, however,~~ should be made in accordance with the implementation guidance provided by FASAB through one or more Technical Releases. [Footnote 33B] ~~issued by OMB as discussed above.~~ Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

[Footnote 33: OMB Circular A-25 addresses user charges by federal entities.]
[Footnote 33A: Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting. (See also SFFAS 6, Accounting for Property, Plant, and Equipment, footnote 27.)]

[Footnote 33B: Technical Release (TR) 8, Clarification of Standards Relating to Inter-Entity Costs provides implementation guidance. Additional TRs may be provided by FASAB if needed.]

5. This paragraph amends the sub-title "Accounting and Implementation Guidance" of SFFAS 4 that precedes paragraphs 108 - 109 by adding a reference to the Recognition paragraphs in SFFAS 4. It does not amend the language contained within those paragraphs.

Accounting and Implementation Guidance [Footnote 31A]

[Footnote 31A: These paragraphs should be read in conjunction with "Recognition" paragraphs 110- 113 to provide a complete understanding of the implementation of standard on inter-entity costing due to different recognition requirements for certain types of activities.]

6. This paragraph amends SFFAS 4 by adding a new sub-title "Component Reporting Entity Disclosures" following paragraph 113 and adding paragraph 113A.

Component Reporting Entity Disclosures

113A. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full cost. An example disclosure includes:

> Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed [by the component reporting entity] are recognized as imputed cost [in the Statement of Net Cost], and are offset by imputed revenue [in the Statement of Changes in Net Position]. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgment Fund.[3] However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

7. As a result of the above changes, business-type activities are still required to recognize inter-entity costs. Although recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel

[3] For simplicity, the illustration addresses only the unreimbursed costs required to be imputed by accounting standards. Component reporting entities should identify the general nature of other imputed costs recognized in their financial statements.

benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

Rescission of Interpretation 6, *Accounting for Imputed Intra-Departmental Costs: An Interpretation of SFFAS 4*

8. This paragraph rescinds Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4,* in its entirety.

Effective Date

9. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Earlier implementation is permitted.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

Department of Defense Implementation Guidance Request Project

A1. Since 2014, the Department of Defense (DoD) has requested the Federal Accounting Standards Advisory Board's (FASAB or "the Board") consideration of several financial reporting areas of concern and related audit challenges. While DoD continues its efforts to comply with the Chief Financial Officers Act of 1990 (as amended), it has noted certain challenges in satisfying existing standards including SFFAS 4. Through its goals to associate costs with the related operating activities, SFFAS 4 creates special challenges to large, complex and matrixed organizations such as DoD.

A2. There are many complex relationships among the components of DoD, such as the military services, as well as between DoD and other related departments, such as the U.S. Coast Guard. Many specialized components provide services to other components of DoD. Generally, DoD operates in a matrixed environment. It shares resources, such as employees and assets, across sub-components that have different functional disciplines to accomplish a shared assignment or mission. Often this is done without removing the resources and associated cost from the sub-component. Because of the extensive sharing of resources, implementing the inter-entity costing requirements would be more challenging and costly to DoD than other departments.

A3. For example, the Defense Security Service's (DSS) mission includes a variety of security functions for DoD. While it may be obvious that the security functions are for the benefit of all DoD reporting entities, Congress appropriates the funding to DSS and the cost is primarily (but not always) assumed by DSS. Financial accounting requirements seek to associate the costs of security functions with the activities that benefit from them. For example, the military services request security services but may not be required by law or management practices to fund those security services. Under prior accounting standards, the cost of services would have been associated with each military service through an imputed cost. However, given the complexity of DoD's components and operations, it may not be cost effective to impute costs for such services. In addition, the benefit of doing so may be reduced at DoD in comparison to other federal departments and agencies due to the challenge of identifying outputs and associating outputs with a single reporting entity.

Generally Accepted Accounting Principles History

A4. FASAB issued SFFAS 4 in July of 1995, and it became effective in fiscal year (FY) 1998. However, the requirement for imputing inter-entity costs that are not reimbursed or are under-reimbursed was not immediately effective in FY1998. The Board explained this in the SFFAS 4 basis for conclusions as follows:

> 248. As discussed above, the Board realizes that there may be problems in implementing the standard on inter-entity costing. Recognition of non-reimbursed or under-reimbursed inter-entity costs is a new concept to federal entities and involves a new way of thinking about costs. There is concern that application of the standard may be inconsistent among federal entities. In addition, there could be problems, particularly at first, in developing estimates of costs; in revising accounting systems and procedures to accommodate these requirements; and in training personnel to accomplish the task. Furthermore, the Board recognizes the concern that some have about the elimination of inter-entity cost transactions for consolidated reporting since the accounting procedures may be complicated.
>
> 249. As a result of these problems and concerns, the Board has expressed the need to take a measured, step-by-step, practical approach to implementation of this standard. Therefore, the Board has decided that, in implementing the standard, it recommends that OMB, with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing and OMB should then issue guidance identifying those costs. OMB should consider the requirements of the standard including the recognition criteria in developing the guidance and it should also consider suggestions and information provided by Treasury, GAO, and other agencies. The Board anticipates the largest and most important inter-entity costs will be identified first, followed by others as entities gain experience in the application of the standard. This approach is seen as a practical way to ensure uniformity in the application and implementation of the standard and to provide time and experience in overcoming any other practical problems which may arise. Also, the Board may recommend specific inter-entity costs for recognition in possible future recommended standards.

A5. In April 2003, the Board issued Interpretation 6 requiring implementation of inter-entity costing for costs between reporting entities that are part of the same department of a larger reporting entity. The requirement was effective for FY 2005.

A6. In August 2005, the Board issued SFFAS 30, requiring full implementation of the inter-entity cost provision in FY 2009. SFFAS 30 followed extensive research on inter-entity costs by an Accounting and Auditing Policy Committee (AAPC) task force. The results were described in the in SFFAS 30 as follows:

> 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 limitation in recognizing inter-entity costs was an impediment to progress towards full costing. The task force did not recommend changes to the current limitations in the application of SFFAS 4 inter-entity costs provisions. 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 report is available on the AAPC website at http://files.fasab.gov/pdffiles/aapciectfreport.pdf.

A7. As provided in paragraphs 28-30 of the basis for conclusions in SFFAS 30, half the respondents disagreed with the proposal that led to SFFAS 30:

> 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.

A8. In summary, in its due process of SFFAS 30, the Board determined the main concerns identified by respondents included (1) the lack of implementation guidance and (2) costs not being recognized consistently across agencies. These concerns also supported the task force findings. Therefore, the Board determined that there was a need for additional guidance, which led to the development of Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs.* The Board concluded that the standards, along with the issuance of TR 8, balanced the concerns expressed by the task force and the ultimate goals of SFFAS 4. The majority of the Board determined SFFAS 30 was essential to attain the full cost accounting envisioned by SFFAS 4.

Existing Practices (Current SFFAS 4 Imputed Costs)

A9. The goal of SFFAS 4, as amended, to identify full cost is critical to improving performance measurement. This Board understands the previous Board's reasons for issuing SFFAS 30 because paragraphs 34-36 of SFFAS 4 explain the following:

> 34. 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."
>
> 35. *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. (emphasis added)
>
> 36. Thus … performance measurement requires both financial and non-financial measures. *Cost is a necessary element for performance measurement, but is not the only element.* (emphasis added)

A10. Currently, the inter-entity cost provisions have been implemented as envisioned by most agencies. However, the effect of inter-entity costs other than those associated with personnel benefits and Treasury Judgment Fund activities has been significantly less than one percent of gross costs at most agencies, calling into question the cost benefit of the original Statement. FASAB received additional feedback about imputed costs from representatives of the largest agencies at roundtables on streamlining financial reporting. The comments were consistent with the results that imputed costs are often immaterial at the departmental level. In addition, feedback was consistent that where the outcome of operations requires many sub-components to work together in a matrixed environment (not only for DoD but other departments such as Health and Human Services), relating cost to performance of each sub-component is challenging.

A11. In addition, ongoing implementation efforts at DoD are expected to be very costly given the complex operating relationships among the sub-components of DoD. Consideration of DoD's implementation challenges and the experiences of other federal reporting entities (described above) led to the Board's reconsideration of the requirements contained within SFFAS 4 and SFFAS 30 under FASAB's Evaluation of Existing Standards project so that any changes would be applicable government-wide.

A12. Board members agree inter-entity cost must be imputed for those reporting entities conducting business-type activities because the information is directly tied to rates. However, there are certain reporting entities or departments where the operating environment does not lend itself to full cost. For example, there are large, complex departments that may have sub-components that are not distinct for performance purposes. Therefore, the ability to relate cost to performance is more challenging for certain organizations than for others.

A13. For example, within DoD, under existing accounting standards, the full cost of inter-entity services would be associated with each military service through an imputed cost. However, given the complexity of DoD's components and operations, it may not be cost effective to impute costs for such services. In addition, the benefit of doing so may be reduced due to the challenge of identifying outputs and associating outputs with a single reporting entity such as a military service.

A14. Based on a government-wide review of (unaudited) percentages of gross cost attributable to imputed costs other than those for personnel benefits and Treasury Judgment Fund settlements, the Board observed the imputed costs are often immaterial at the department level. Personnel benefits and Treasury Judgment Fund settlements are required to be imputed by GAAP standards other than SFFAS 4, and those standards ensure they continue to be imputed.[4] The modifications herein restore the option for future recognition of other inter-entity costs if OMB decides to do so.

[4]See (1) paragraphs 93-95 of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, for the costs of employees' benefits, (2) paragraphs 74-76 of SFFAS 5, *Accounting for Liabilities of The Federal Government*, for the pension's costs subset for personnel benefits, and (3) Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*, for Treasury Judgment Fund settlements.

A15. The Board carefully considered the cost benefits, operating environments, current reporting, and what must be accomplished for those reporting entities that had not implemented the requirements. After careful consideration, the Board concluded that the standard will not have negative consequences to reporting entities and that its benefits will clearly exceed its costs for reporting entities that had not implemented inter-entity cost requirements as well as reduce the reporting burden for agencies that have been imputing such costs. Therefore, based on research and the current costs to comply with existing standards, the Board decided to amend existing standards by requiring the reporting of inter-entity costs (other than those associated with personnel benefits and the Treasury Judgment Fund settlement, which is required for all entities) to business-type activities.

Summary of Outreach

A16. FASAB issued the exposure draft (ED) *Amending Inter-entity Cost Provisions* on September 1, 2017, with comments requested by November 30, 2017.

A17. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, FASAB News, the *Journal of Accountancy*, Association of Government Accountants Topics, the CPA *Journal, Government Executive, the CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A18. FASAB received 16 responses from preparers, auditors, users of federal financial information, and professional associations. The Board did 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 considered each response and weighed the merits of the points raised. The respondents' comments are summarized below. The respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A19. The majority of respondents agreed with the proposal to revise SFFAS 4 to provide for recognition of inter-entity costs by business-type activities and to rescind SFFAS 30 and Interpretation 6.

A20. One respondent (the Department of Agriculture) disagreed because it believed recognition of inter-entity costs that are not fully reimbursed should not be limited to business-type activities. The respondent explained that the Commodity Credit Corporation (CCC) has no employees[5] or facilities, and the imputed costs are roughly 10% of operating costs. With further evaluation and consideration of the scenario, the Board determined it may be appropriate to revise the proposed language to remove the word "limit" and allow non-business type activities the election to recognize other imputed costs.

A21. Based on certain responses, there appeared to be confusion regarding the recognition of inter-entity costs by activities that are not business-type activities. The Board clarified the summary, standards, and basis for conclusions to ensure the language regarding recognition of inter-entity costs by activities that are not business-type activities was explicit.

A22. The language explained that with the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, as amended are restored to their original language. However, FASAB adjusted the standards to require business-type activities to recognize inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed costs and corresponding imputed financing for other types of inter-entity costs.

A23. With the amendments presented in this Statement, the revised paragraphs 110-111 of SFFAS 4 are as follows:

> Recognition
>
> 110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by federal entities. The Office of Management and Budget may issue guidance identifying additional inter-entity costs entities should recognize. The inter-entity costs should be specified in accordance with this standard including the recognition criteria presented in paragraphs 111 through 113.

[5]The Commodity Credit Corporation (CCC) is a Government-owned and operated entity that was created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their orderly distribution. … CCC has no operating personnel. Its price support, storage, and reserve programs, and its domestic acquisition and disposal activities are carried out primarily through the personnel and facilities of the Farm Service Agency (FSA). (https://www.fsa.usda.gov/about-fsa/structure-and-organization/commodity-credit-corporation/index)

111. Recognition of all significant inter-entity costs is important when those costs constitute inputs to government goods or services provided for a fee or user charge. Generally, the fees and user charges should recover the full costs of those goods and services. [Footnote 33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold by the federal government. Recognition of inter-entity costs supporting business-type activities [Footnote 33A] and recognition of inter-entity costs for non-business type activities that elect to do so should be made in accordance with implementation guidance provided by FASAB through one or more Technical Releases. [Footnote 33B] Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

[Footnote 33: OMB Circular A-25 addresses user charges by federal entities.]
[Footnote 33A: Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.* (See also SFFAS 6, Accounting for Property, Plant, and Equipment, footnote 27.)]
[Footnote 33B: Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs* provides implementation guidance. Additional TRs may be provided by FASAB if needed.]

A24. While agreeing with the proposal, one respondent suggested certain provisions of the proposed statement appear to be in conflict. The respondent noted SFFAS 4 appears to require all reporting entities to recognize the full costs of services received from other federal reporting entities even if there is no requirement to reimburse the providing entity for the full cost. This respondent believed that certain elements of the proposal appear to contradict certain portions of SFFAS 4. The Board acknowledges the ambiguity created by the interrelation of the full cost and inter-entity standards contained in different sections of SFFAS 4. This ambiguity is further complicated if particular paragraphs or sentences of SFFAS 4 are read in isolation.

A25. The focus of this Statement is narrow and the Board did not undertake a review of SFFAS 4 in its entirety. The Board addressed the ambiguity by adding clarifying language where appropriate, which included a new footnote to an earlier section within the SFFAS. The new footnote explains the recognition paragraphs (par. 110-113) should be considered in conjunction with other sections to provide a complete understanding regarding the implementation of inter-entity costing due to different recognition requirements for different types of activities.

A26. The majority of respondents generally agreed that component reporting entities should provide a concise statement to acknowledge that significant services were received for which no cost is recognized. However, certain respondents suggested additional explanation and clarification regarding the disclosure. The respondents believed providing clarity in these areas would ensure consistency and reduce costs associated with preparation and audit. Certain respondents also suggested sample wording of the disclosure.

A27. The Board believed the comments indicated concern regarding the "costs" of determining whether unreimbursed inter-entity costs are "significant" and whether the proposed disclosure, without details of specific costs excluded, provided a meaningful distinction between entities with and without "significant inter-entity costs". Based on the comments, the Board determined the disclosure requirements should be revised. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full cost. In addition, the Board included sample wording for the disclosure in the Statement. The Board believed the sample wording would provide the minimum disclosure and that if the reporting entity recognized other imputed costs, that fact should be disclosed as well.

A28. Although the Board concluded that the proposed Statement will reduce the reporting burden for agencies, it recognizes that any change in standards may require time to implement. Therefore, the Board changed the effective date to be effective for reporting periods beginning after September 30, 2018, with earlier implementation permitted.

A29. As explained in paragraph 12 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7*, Accounting for Revenue and Other Financing Sources, "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Therefore, reporting entities follow the guidance in SFFAS 21 paragraph 13.a. - 13.c. for all changes in accounting principles:

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.

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.

Board Approval

A30. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

Statement of Federal Financial Accounting Standards 56: Classified Activities

Status

Issued	October 4, 2018
Effective Date	For periods beginning after September 30, 2018.
Affects	None.
Affected by	None.
Related Guidance	Interpretation 8

Summary

The objective of this Statement is to balance the need for financial reports to be publicly available with the need to prevent the disclosure of classified national security information or activities in publicly issued General Purpose Federal Financial Reports (GPFFRs). This Statement allows financial presentation and disclosure to accommodate user needs in a manner that does not impede national security.

This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.

Further, Interpretations of this Statement, which may themselves contain classified information, will address the requirements of this and other standards and permit other modifications when needed to prevent the disclosure of classified information. Modifications permitted by this Statement and future Interpretations may affect the net results of operations and/or net position of those entities applying the Interpretations.

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.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that issue unclassified general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

2. This Statement does not apply to the reporting of financial information within the GPFFR in the classified environment and only applies when the information is presented in the unclassified environment, such as publicly available component reporting entity GPFFRs. This Statement does not apply to classified GPFFRs provided to cleared personnel, including elected officials. This does not relieve reporting entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment.

Definitions

3. **Classified National Security Information**, also known as "classified information," is any information that has been determined pursuant to Executive Order (EO) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

    a. **TOP SECRET,** which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;

    b. **SECRET,** which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and

    c. **CONFIDENTIAL,** which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

4. **Original Classification Authority** is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.

5. **Derivative Classification** is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

Application of Standards and Disclosures

6. Classified information is prohibited from public release. Classified information is determined by an Original Classification Authority (OCA) or by applying derivative classification.

7. Reporting entities are expected to comply with other accounting standards in the appropriate classified environment. Reporting entities should apply this Statement when an OCA concludes, or others determine by applying derivative classification, that the information is classified and, therefore, cannot be presented without modification in unclassified GPFFRs. Component reporting entities have the discretion to apply this Statement at the program or transaction level.

8. This Statement permits certain modifications to prevent the disclosure of classified information in an unclassified GPFFR. This Statement permits the following:

   a. An entity may modify information required by other standards if the effect of the modification does not change the net results of operations or net position.

   b. A component reporting entity is allowed to be excluded from one reporting entity and consolidated into another reporting entity. The effect of the modifications may change the net results of operations and/or net position.

   c. An entity may apply Interpretations of this Statement that allow other modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position.

The above modifications allowed by this Statement are discussed in more detail in paragraphs 9-11 below.

Presentation and Disclosure Modifications

9. The entity should modify unclassified financial statement presentations, disclosures, required supplementary information (RSI), and required supplementary stewardship information (RSSI) required by other Statements to prevent the disclosure of classified information if the effect of the modification does not change the net results of operations or net position. In this context, modify means:

   a. Presenting amounts associated with one financial statement line item in another financial statement line item but not presenting narrative explaining the modification.

   b. Omitting required disclosures, RSI, or RSSI that would otherwise reveal classified information.

Consolidation Modifications

10. An organization may be excluded from a particular reporting entity to prevent the disclosure of classified information and consolidated into another reporting entity. According to SFFAS 47, *Reporting Entity*, there are organizations[1] that should be included in a particular component reporting entity's GPFFR. Such organizations may be excluded from the particular component reporting entity's GPFFR to prevent the disclosure of classified information and consolidated into another reporting entity.[2] If a reporting entity consolidates an organization that is excluded from another reporting entity's GPFFR to prevent the disclosure of classified information, that consolidation modification may affect one or both reporting entities' net results of operations and/or net position.

Interpretations

11. The Board may issue Interpretations of this Statement that affect other Statements. Such Interpretations may permit other unclassified GPFFR presentation and disclosure

[1]Decisions to exclude an organization from a particular component reporting entity to prevent the disclosure of classified information may be evidenced by, for example, approval or concurrence from an oversight organization, such as the Office of Management and Budget.

[2]SFFAS 47, *Reporting Entity*, provides the framework for determining what organizations (for example, component reporting entities or sub-components) should be included in the reporting entity's GPFFRs for financial accountability purposes. A reporting entity may be the government as a whole, another component entity, or a subcomponent reporting entity.

modification options, as needed. These modification options would prevent unauthorized disclosure in an unclassified GPFFR. Modifications that affect the entity's net results of operations and/or net position may be allowed by Interpretations of this Statement.

Component Reporting Entity Disclosures

12. All federal component reporting entities must include the following in the summary of significant accounting policies.

    Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

Component reporting entities must not disclose application of this Statement, including any Interpretations of this Statement.

Financial Report of the U.S. Government Disclosures

13. The financial report of the U.S. Government (government-wide financial report) must include the following in the government-wide summary of significant accounting policies.

    Accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information. Accordingly, modifications may have been made to certain presentations and disclosures.

The government-wide financial report must not disclose specific Interpretations of this Statement that may have been applied.

Effective Date

14 This Statement is effective upon issuance.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. In August 2016, the Department of Defense (DoD or the Department) identified several areas for the Federal Accounting Standards Advisory Board's consideration where the application of general accepted accounting principles would result in the exposure of classified information. As the DoD was preparing to commence full-scope financial statement audits, it identified specific accounting standard requirements that would conflict with its responsibility to prevent the unauthorized disclosure of information in accordance with Executive Order (EO) 13526 of December 29, 2009, "Classified National Security Information."

A2. Specifically, EO 13526 recognizes, "Our democratic principles require that the American people be informed of the activities of their Government. Also, our Nation's progress depends on the free flow of information both within the Government and the American people. Nevertheless, throughout our history, the national defense has required that certain information be maintained in confidence in order to protect our citizens, our democratic institutions, our homeland security, and our interactions with foreign nations. Protecting information critical to our Nation's security and demonstrating our commitment to open Government through accurate and accountable application of classification standards and routine, secure, and effective declassification are equally important priorities."

A3. Executive Order 13526, SEC 1.4 authorizes classification of information regarding the following types:

- military plans, weapons systems, or operations;
- foreign government information;

- intelligence activities (including covert actions), intelligence sources or methods, or cryptology;
- foreign relations or foreign activities of the United States, including confidential sources;
- scientific, technological, or economic matters relating to the national security;
- United States Government programs for safeguarding nuclear materials or facilities;
- vulnerabilities or capabilities of systems, installations, infrastructures, projects, plans, or protection services relating to the national security; or
- the development, production, or use of weapons of mass destruction.

Unauthorized disclosure of classified information is prohibited by Title 18 U.S. Code, Section 798.

Summary of Outreach Efforts and Responses

A4. FASAB issued the ED, titled *Classified Activities* on December 14, 2017, with comments requested by March 16, 2018. Upon release of the ED, FASAB provided notices and press release to the FASAB email listserv, the *Federal Register*, *FASAB News*, *the Journal of Accountancy, Association of Government Accountants Topics*, the *CPA Journal, Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on ED's in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A5. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Homeland Security Committee: Full Committee

b. House Homeland Security Committee: Sub-committee on Oversight and Management Efficiency

c. House Homeland Security Committee: Sub-committee on Counterterrorism and Intelligence

d. Senate Select Committee on Intelligence

e. House Permanent Select Committee on Intelligence

f. Senate Armed Services Committee

g. House Armed Services Committee

h. House Oversight and Government Reform Committee

i. Senate Homeland Security and Governmental Affairs Committee

j. Senate Appropriations Committee

k. House Appropriations Committee

A6. FASAB received 17 responses from preparers, auditors, and professional associations. Many respondents had concerns with how to inform readers of GPFFRs regarding the potential modifications given the classified nature of the modifications themselves. The Board has revised the disclosure requirements to address the respondents' concerns. The Board has also incorporated revisions proposed by some respondents to clarify this Statement or address issues in the basis for conclusions.

A7. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

Standards on Classified Activities

A8. There are many component reporting entities engaged in classified activities. In the recent past, information regarding the total amount budgeted for such classified activities was not publicly disclosed. However, in the last decade, changes were made so that highly aggregated budget numbers for such activities would be made available. Details remain classified including the amount of funding for particular components within the intelligence community and other departments or agencies. Disclosure of the disaggregated funding details would harm national security interests.

A9. Similarly, disaggregated detailed financial reporting could also harm national security interests. To address the issue of classified information being revealed by applying the requirements of SFFAS 47, *Reporting Entity*, this Statement permits certain modifications and disclosures at both the component reporting entity level and at the government-wide level.

A10. The Board had several discussions with national security experts and stakeholders that allowed the Board the opportunity to evaluate the available options for presenting classified information in unclassified GPFFRs without jeopardizing national security, including the specific options suggested by respondents. The Board determined that options other than those permitted in this Statement may not always adequately resolve national security concerns. Therefore, based on the evaluation of the options, the Board concluded that this Statement and future related Interpretations provide the optimal solution. This option would allow reporting entities to issue unclassified, publicly available financial statements that comply with accounting standards. Without this Statement, there is a risk that reporting entities may need to classify their entire financial statements to comply with existing accounting standards, which would likely result in the need to classify a large portion of the government-wide financial statements.

A11. Some respondents suggested that the Board require component reporting entities to only disclose that certain presentation and disclosure modifications have been made when the entity has applied this Statement to prevent the disclosure of classified information. The Board, in consultation with national security stakeholders, concluded that the identification by a component reporting entity that this Statement has been applied would reveal classified information. Doing so would allow GPFFR users to identify component reporting entities with and without modifications. Further, users could identify changes among component reporting entities over time if modifications are disclosed in some reporting periods but not others. Therefore, the Board is requiring a more neutral disclosure for component reporting entities and the government-wide entity to prevent specific identification of component reporting entities applying this Statement. This neutral disclosure

a. protects the identity of those component reporting entities that have made modifications to prevent the disclosure of classified information, and

b. avoids implying that a component reporting entity has made a modification when they have not.

A12. This Statement and future Interpretations would be applied as needed based on an assessment of the need to prevent the disclosure of classified information or to assist other departments and agencies by including an organization as described in paragraph 10. During the audit, the preparer would inform the properly cleared auditor whether and how this Statement and related Interpretations were applied. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

A13. Some respondents questioned the proposal to require documentation retained in the appropriate environment to adequately support classified information and modifications. Such documentation was intended to allow recorded amounts modified to prevent the disclosure of classified information to reconcile in aggregate to unmodified schedules or other documentation subject to audit. Upon review, members noted that the proposed requirement related to systems, controls, and audit procedures. This proposed level of detail regarding documentation exceeded that of other financial accounting standards.

A14. The Board believes that standards regarding the underlying documentation of modifications are unnecessary and has removed the proposed requirement. The Board expects that - as with other aspects of financial statements - the preparer will maintain sufficient documentation to support modifications. Such documentation is an important aspect of management control over financial reporting. The documentation will be available during the audit but in an environment appropriate to classified information.

A15. Modifications may not be needed to prevent the disclosure of certain classified information. Therefore, this Statement permits, rather than requires, modifications on a case-by-case basis.

Process for Future Classified Interpretations

A16. The Board anticipates issuing classified Interpretations of this Statement to address specific issues raised by affected component reporting entities. The Board has established a process to engage cleared stakeholders in due process regarding classified Interpretations of this Statement. The process will engage users of information related to classified activities.

A17. The six-step process established in the "Memorandum of Understanding among the Government Accountability 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" will be followed in developing classified Interpretations. Appropriate protections will be applied to classified information, consistent with federal law applicable to federal advisory committees and their activities involving information classified pursuant to Executive Order. The six-step process for classified Interpretations and related protections are described below.

a. Identification of accounting issues and agenda decisions

    i. The Board will carry out this step by consulting with cleared stakeholders in secure facilities. Stakeholders - including preparers, auditors, and users of classified information - will be informed regarding the process for raising issues for Board consideration.

b. Preliminary deliberations

    i. Preliminary deliberations will engage all members of the Board. Deliberations will occur during closed meetings. Closed meetings will be approved and announced in the Federal Register consistent with the process established in the Federal Advisory Committee Act.

c. Preparation of initial documents (issues papers and/or discussion memoranda)

i. We expect that all initial documents will contain classified information and will therefore be subject to federal requirements pertaining to classified information. Initial documents will be prepared by cleared individuals of FASAB staff and representatives of affected organizations who have original or derived classification authority.[3] Such documents will be shared with members in a setting appropriate to the classification level of the documents. Members will be afforded adequate time to review the materials, ask questions, and deliberate over the materials before making decisions regarding the issues raised.

d. Release of documents to the public, public hearings, and consideration of comments

i. Members of the public will have an opportunity to comment on the proposed Statement. The public will be able to comment on the general subject matter discussed in the proposed Statement and the existence of classified Interpretations. The Board will consider all comments provided.

ii. Also, because we expect that all documents related to Interpretations will contain classified information, release will be limited to cleared individuals and organizations that have signed a non-disclosure agreement and have a need-to-know, in accordance with federal requirements pertaining to classified information. The Board will ensure a representative group of stakeholders with varied perspectives and appropriate clearances are engaged. The Board expects to seek input from elected representatives of the public and appointed government officials to ensure the needs of citizens are balanced against national security interests. The Board will consider all comments and input received from the representative group of stakeholders.

e. Further deliberations, exposure draft, and consideration of comments

i. This step will occur in closed sessions as noted above. The Board will seek input from cleared individuals, including elected and appointed officials, and organizations to the greatest extent possible given the classified nature of the

[3]The Board does not have specific original classification authority. The classification level of all work products will be determined by those with that authority.

materials and deliberations. The Board will consider all comments and input received from the representative group of stakeholders.

f. Vote to approve proposed Interpretations

i. Consistent with the Board's established procedures for consideration of proposed Interpretations, final classified Interpretations will be those approved by a majority of the members and not objected to by a member representing the Comptroller General, the Secretary of the Treasury, or the Director of OMB during a 45-day review period. Final classified Interpretations will be maintained by FASAB. Component reporting entities should contact FASAB to arrange access to the classified Interpretations as needed. FASAB will provide access to any relevant Interpretations following appropriate security procedures.

A18. This approach balances the public's interest in financial information with the need to prevent the disclosure of classified information. The Board's role in promulgating classified Interpretations is to appropriately guide the modifications used in preventing the disclosure of classified information.

A19. The Board may issue Interpretations and implementation guidance in the classified environment. The issuance of classified Interpretations and guidance by the Board will be publicly announced in the Federal Register and on the FASAB website. The public will be made aware of the guidance's existence and the unclassified title of the guidance. All classified guidance will be made available only to those individuals who have been designated as having a need to know and who hold the proper clearances.

Board Approval

A20. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

Statement of Federal Financial Accounting Standards 57: Omnibus Amendments 2019

Status

Issued	September 27, 2019
Effective Date	Paragraphs 9 and 10 are effective upon issuance. Paragraph 2 is effective for reporting periods beginning after September 30, 2019. Early adoption is not permitted. Paragraphs 3 through 8, 11, and 12 are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.
Affects	• SFFAS 5, par. 15 • SFFAS 6, par. 18, 26 • SFFAS 8 is rescinded. • SFFAS 49, par. 15.b, footnote 7
Affected by	SFFAS 58 amends the effective date in par. 15.

Summary

The objective of this Statement is to address consistency issues and other improvements that have been identified during implementation and application of certain FASAB Statements. This Statement:

- eliminates the required supplementary stewardship information (RSSI) category by rescinding Statement of Federal Financial Accounting Standards (SFFAS) 8, *Supplementary Stewardship Reporting*,

- updates references to leases in SFFAS 5, *Accounting for Liabilities of the Federal Government,* SFFAS 6, A*ccounting for Property, Plant, and Equipment, and SFFAS 49, Public-Private Partnerships: Disclosure Requirements*, and

- makes a minor change to SFFAS 6.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

Eliminating the Required Supplementary Stewardship Information Category

2. This paragraph rescinds SFFAS 8, *Supplementary Stewardship Reporting*, in its entirety, including the requirement for reporting information in the required supplementary stewardship information (RSSI) category.

Amendments to SFFAS 5, 6, and SFFAS 49

[Paragraphs 3 - 12 below will become effective when SFFAS 54, Leases: An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment becomes effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.]

3. SFFAS 54, Leases: *An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*, amended the lease standards in SFFAS 5 and 6. This Statement amends certain references to leases affected by SFFAS 54 as well as other minor changes to improve clarity of existing Statements.

4. Specifically, this Statement amends the following documents:

   - SFFAS 5, *Accounting for Liabilities of the Federal Government*
   - SFFAS 6, *Accounting for Property, Plant, and Equipment*
   - SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*

5. This paragraph amends paragraph 15 of SFFAS 5 to remove a reference to capital leases:

15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, ~~capital leases~~, federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

6. The revised paragraph 15 of SFFAS 5 is as follows:

15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

7. This paragraph amends paragraph 18 of SFFAS 6 by revising the first bullet to remove a reference to capital leases:

18. Property, plant, and equipment also includes:

- assets ~~acquired through capital~~ <u>recognized as a result of</u> leases <u>(see SFFAS 54: Leases, for guidance regarding leases and leasehold improvements to be recognized as PP&E assets)</u> ~~(See paragraph 20), including leasehold improvements~~;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[footnote omitted]

8. The revised paragraph 18 of SFFAS 6 is as follows:

18. Property, plant, and equipment also includes:

- assets recognized as a result of leases (see SFFAS 54: *Leases*, for guidance regarding leases and leasehold improvements to be recognized as PP&E assets);
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[footnote omitted]

9. This paragraph amends paragraph 26 of SFFAS 6 by revising the final bullet to remove a reference to "material amounts"; materiality applies to all of the bulleted items

26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the

historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- "transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- ~~material amounts~~ of interest costs paid.[footnote omitted]

10. The revised paragraph 26 of SFFAS 6 is as follows:

26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;

- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- "Interest costs paid.[footnote omitted]

11. This paragraph amends footnote 7 of paragraph 15.b in SFFAS 49 by revising the footnote to remove the reference to capital and operating leases:

    15. The following arrangements and transactions are not subject to the provisions of this Statement:

    a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

    b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

    FN 7 – The term leases<u>, as defined under FASAB standards,</u> includes enhanced use leases~~ and both capital and operating leases~~, ~~as defined under current FASAB standards~~.

    FN 8 – A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, ~~software~~ <u>product</u> updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

12. The revised footnote 7 of paragraph 15.b in SFFAS 49 is as follows:

    15. The following arrangements and transactions are not subject to the provisions of this Statement:

a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

FN 7 - The term leases, as defined under FASAB standards, includes enhanced use leases.

FN 8 - A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, product updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

Effective Date

13. Paragraphs 9 and 10 of this Statement are effective upon issuance.

14. Paragraph 2 of this Statement is effective for reporting periods beginning after September 30, 2019. Early adoption is not permitted.

15. Paragraphs 3 through 8, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

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

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

Required Supplementary Stewardship Information

A1. SFFAS 8 established the RSSI category to distinguish information about the government's stewardship from basic financial statements and required supplementary information (RSI). The Federal Accounting Standards Advisory Board (FASAB or "the Board") reasoned that information about the government's stewardship may include non-financial data, may be based on projections or assumptions, and may not articulate with basic financial statements.[1] In addition, the importance of stewardship information needed to be highlighted[2] and receive more audit scrutiny than RSI.[3]

A2. Audit guidance for RSSI, however, was never developed. The Board consequently began eliminating the category by reclassifying most of the RSSI elements to the basic financial statements or RSI. Only the stewardship investments information remained in RSSI and this Statement eliminates the requirement to present stewardship investments trend information as RSSI.

[1]SFFAS 8, par. 20.

[2]SFFAS 8, par. 111.

[3]SFFAS 8, par. 114.

A3. While the Board questioned whether the RSSI category should be eliminated, stewardship investment information in some form can help users assess whether government operations have contributed to the nation's current and future well-being. Stewardship investments include expenses incurred for nonfederal physical property, such as highways and bridges; expenses incurred to increase or maintain national economic productive capacity, such as investments in human capital; and expenses incurred for research and development that are intended to provide future benefits or returns. However, outreach regarding this proposal revealed that users may define "investment" more broadly than SFFAS 8 and prefer cash basis data that the Office of Management and Budget reports annually.

Leases

A4. The Board believes it is appropriate to amend the necessary standards to eliminate references to "capital" and "operating" leases used prior to the issuance of SFFAS 54. The terms "capital" and "operating" leases were eliminated with the issuance of SFFAS 54. This proposal provides conforming amendments to the following statements:

- SFFAS 5, *Accounting for Liabilities of the Federal Government*
- SFFAS 6, *Accounting for Property, Plant, and Equipment*
- SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*

Clarity Amendments

A5. Paragraph 26 of SFFAS 6 provides examples of costs that may be included as capitalized cost of acquiring PP&E. One example references "material amounts of interest cost paid." Some found it confusing to qualify only one of the examples as "material," but not the others. The Board believes removing the reference to "material amounts" will not change existing practice while improving the clarity of existing standards.

Summary of Outreach Efforts and Responses

A6. FASAB issued the exposure draft (ED) on February 22, 2019 with comments requested by April 23, 2019. Upon release of the ED, notices and press releases went to the following: the *Federal Register*, *FASAB News*, the J*ournal of Accountancy*, *AGA Today*, the CPA J*ournal, Government Executive and the CPA Letter*, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency (CIGIE), the Financial Statement Audit Network; and committees of professional associations generally commenting on EDs in the past.

A7. FASAB received a total of 11 responses from preparers, auditors, and professional associations. The majority of respondents generally agreed with the Board's proposal to eliminate the RSSI category by rescinding SFFAS 8. Respondents noted that the proposal would remove a reporting requirement that users, in their observation, have not relied upon or utilized. .

A8. Respondents that did not agree with the proposal to eliminate the RSSI category noted that a separate category highlights the importance of the stewardship information and distinguishes it from other information. Stewardship information also informs users on the extent of investments that provide long-term benefits for the nation.

A9. Eliminating the RSSI category does not preclude preparers from reporting investment information in management's discussion and analysis (MD&A), other information, or both. Also, preparers have the discretion to employ the technology they deem appropriate for assisting users in locating the information within their GPFFR and among other reporting that may provide more detailed information.

A10. Stewardship investments may be significant for some reporting entities and warrant discussion in the MD&A. SFFAS 15, Management's Discussion and Analysis, states that 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."[4]

A11. Given the Board's decision to eliminate the RSSI category, the majority of respondents agreed that guidance on reporting stewardship investment information in MD&A would be needed. Guidance would help ensure that reporting entities consistently provide the information that would be most beneficial to users. The Board is conducting a project on improving MD&A, and the project will consider the respondents' concerns and suggestions.

A12. Regarding the clarity amendments, all of the respondents agreed with the proposal to update references to leases in SFFAS 5, SFFAS 6, and SFFAS 49, and make a minor change for clarity. Based on a suggestion from a respondent, the Board edited proposed language to clarify a reference to leasehold improvements. Also, respondents suggested additional changes to SFFAS 6 and other requirements. The Board will review those additional respondent suggestions in future Omnibus amendments or during the evaluation of existing standards.

A13. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the

[4]SFFAS 15, par. 1.

comments. The Board considered each response and weighed the merits of the points raised.

Board Approval

A14. This Statement was approved for issuance by all members of the Board. Ballots are available for inspection at the Board's offices.

Appendix B: Abbreviations

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAS	Statement of Federal Financial Accounting Standards

Statement of Federal Financial Accounting Standards 58: Deferral of the Effective Date of SFFAS 54, Leases

Status

Issued	June 19, 2020
Effective Date	Upon Issuance
Affects	• SFFAS 54, par. 98 • SFFAS 57, par. 15
Affected by	None.

Summary

This Statement defers the effective date for Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*, and *SFFAS 6, Accounting for Property, Plant, and Equipment*, for three years. The requirements of SFFAS 54 will now become effective for reporting periods beginning after September 30, 2023. Early adoption of SFFAS 54 is not permitted.

Most federal reporting entities should continue their current lease accounting practices until SFFAS 54 becomes effective; they should not follow the Financial Accounting Standards Board's (FASB) new lease standards (Accounting Standards Codification - *Leases* - *Topic 842*) nor should they follow the Governmental Accounting Standards Board's (GASB) new lease standards (GASB Statement No. 87, *Leases*).[1] Rather, reporting entities should continue to follow the current FASAB guidance that addresses lease transactions. This comprises paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6. These paragraphs are not rescinded by SFFAS 54 until it becomes effective. Previously-existing FASB guidance under Accounting Standards Codification - *Leases - Topic 840* should continue to be used when the accounting treatment for a lease transaction or event is not specified by paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6.

[1]Except for a limited number of reporting entities permitted to follow FASB generally accepted accounting principles (see SFFAS 34, par. 9-12). Those entities will adopt new lease accounting standards promulgated by FASB as appropriate.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFR), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement amends SFFAS 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*, to defer the effective date of implementation by three years.

3. This Statement also amends SFFAS 57, *Omnibus Amendments 2019*, to defer the effective date of certain conforming amendments contained therein related to SFFAS 54.

Amendment to SFFAS 54

4. Paragraph 98 of SFFAS 54 is amended as follows:

   98. The requirements of this Statement are effective for reporting periods beginning after September 30, ~~2020~~ 2023. Early adoption is not permitted.

Amendment to SFFAS 57

5. Paragraph 15 of SFFAS 57 is amended as follows:

   15. Paragraphs 3 through 8, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, ~~2020~~ 2023. Early adoption is not permitted.

Effective Date

6. The requirements of this Statement are effective upon issuance.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality,* for a detailed discussion of the materiality concepts.

Appendix A: Basis for Conclusions

This appendix discusses some 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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. In April 2018, the Federal Accounting Standards Advisory Board (FASAB or "the Board") issued SFFAS 54. SFFAS 54 provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's GPFFR and include appropriate disclosures. Such standards were set to go into effect for reporting periods beginning after September 30, 2020.

A2. Since the issuance of SFFAS 54, the Accounting and Auditing Policy Committee (AAPC) initiated a project to develop implementation guidance for the federal financial accounting and reporting community on applying the requirements of SFFAS 54.[1] As part of this effort, the Board and AAPC engaged a task force to obtain feedback from stakeholders and constituents and monitor implementation efforts across the federal government.

Summary of Outreach and Responses

A3. The Board believes that SFFAS 54 offers appropriate guidance for the accounting and financial reporting of leases for federal entities and maintains the views expressed in the basis for conclusions to SFFAS 54 regarding costs and benefits. Implementation of SFFAS

[1]The AAPC is a permanent committee established by the Board to assist the federal government in improving financial reporting by timely identifying, discussing, and recommending solutions to accounting issues within the framework of existing authoritative literature. The AAPC works under the general oversight of the Board.

54 will ensure that GPFFR users receive useful information regarding the resources and obligations that support federal programs and activities and can monitor federal investments in property, plant, and equipment, and lease financing activities.

A4. Notwithstanding such benefits, the Board believes a three-year deferral of the effective date of SFFAS 54 is a prudent response commensurate to the identified implementation challenges, costs, and constraints and will allow reporting entities to reliably implement SFFAS 54.

A5. The Board reviewed and discussed implementation issues in August and October of 2019 by reviewing Board and task force briefing materials and receiving feedback and status reports from task force panelists and technical staff.

A6. Through these efforts, the Board gained an understanding of the nature and magnitude of implementation challenges encountered by federal reporting entities. The Board found that challenges were significant for reporting entities with large lease portfolios.

A7. The following factors (not all-inclusive) are examples of significant challenges encountered when implementing SFFAS 54:

a. The need to develop and acquire information technology, data elements, core systems requirements, and internal controls at the government-wide and component reporting entity levels

b. Resource limitations, coupled with extensive preparation activities necessary for implementation

c. The need for the federal financial accounting and reporting community to receive, understand, and apply forthcoming implementation guidance due to the extensive complexity and breadth of implementation issues identified by the leases implementation guidance task force

A8. Based on the initial feedback obtained by the Board and its SFFAS 54 implementation monitoring activities, the Board agreed that proposing a two-year deferral of the effective date of SFFAS 54 in its exposure draft (ED) *Deferral of the Effective Date of SFFAS 54, Leases*, was appropriate. In the proposal, the Board noted that it expected to issue additional SFFAS 54 implementation guidance during fiscal year 2021.

A9. FASAB issued the ED on December 18, 2019, with comments requested by January 31, 2020. Upon release of the ED, notices and press releases went to the following: the Federal Register, the FASAB newsletter, *Journal of Accountancy, Accounting Today*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board), and the roster of AAPC leases implementation task force members and observers.

A10. Twenty-two comment letters were received from preparers, auditors, professional associations, and users of federal financial information. The Board considered responses to the ED at its April 2020 meeting. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. All respondents agreed that a deferral was necessary. Twenty-one of 22 indicated agreement with the two-year deferral, while one of 22 stated that two years would not provide sufficient time to consider forthcoming implementation guidance in conducting implementation preparation activities.

A12. Several respondents agreed with the proposal while expressing concerns about the complexity and breadth of implementation challenges. Respondents also expressed a desire to have sufficient time to consider and integrate forthcoming implementation guidance. A few respondents indicated that ongoing systems development efforts and implementation preparation activities are likely to be affected by such guidance. Some were concerned about risks and costs incurred as a result of compressed timeframes for considering the guidance, once finalized and issued.

A13. Based on the feedback obtained through the leases implementation task force, staff research and outreach, and public comments, the Board concluded that a three-year deferral was appropriate.

A14. Most federal reporting entities will continue their current lease accounting practices until SFFAS 54 becomes effective; they should not follow the Financial Accounting Standards Board's (FASB) new lease standards (Accounting Standards Codification - L*eases - Topic 842*) nor should they follow the Governmental Accounting Standards Board's (GASB) new lease standards (GASB Statement No. 87, *Leases*).[2]

A15. Rather, reporting entities should continue to follow the current FASAB guidance that addresses lease transactions. This comprises paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6. These paragraphs are not rescinded by SFFAS 54 until

[2]Except for a limited number of reporting entities permitted to follow FASB generally accepted accounting principles (see SFFAS 34, par. 9-12). Those entities will adopt new lease accounting standards promulgated by FASB as appropriate.

it becomes effective. Previously-existing FASB guidance under Accounting Standards Codification - *Leases - Topic 840* should continue to be used when the accounting treatment for a lease transaction or event is not specified by paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6.

Board Approval

A16. This Statement was approved for issuance by all members of the Board.

Appendix B: Abbreviations

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
SFFAS	Statement of Federal Financial Accounting Standard

Statement of Federal Financial Accounting Standards 59: Accounting and Reporting of Government Land

Status

Issued	July 30, 2021
Effective Date	• "Par. 1-3: **Scope** - For periods beginning after September 30, 2021. Earlier adoption is not permitted. • "Par. 6-12: **RSI Presentation** - For periods beginning after September 30, 2021 through periods beginning after September 2024. Earlier adoption is not permitted. • "Par. 4 -14: **Basic Presentation** - For periods beginning after September 30, 2025. Earlier adoption is not permitted.
Affects	• SFFAS 6, paragraphs 25,26,35,40,44,45 • SFFAS 7, paragraphs 62,258,259,296,345,346,358,361 • SFFAS 29 paragraphs 33,35,39,40,42 • SFFAS 32 paragraph 23 • SFFAS 42 paragraphs 13,15
Affected by	None.

Summary

The objective of this Statement is to ensure consistent accounting treatment and reporting for federal land.

This Statement sets forth the Federal Accounting Standards Advisory Board's (FASAB or "the Board") agreement with those in the financial reporting community who noted the importance of having accounting standards that provide relevant, reliable, and consistent information concerning federal land.

The Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations such as passage of time and inflation make historical cost less relevant to users. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting estimated acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measures were used to recognize land on the balance sheet.

Prior to the issuance of this Statement, federal accounting standards required the capitalization of the historical cost of general property, plant, and equipment (G-PP&E) land and disclosures regarding restrictions on the use or convertibility of G-PP&E to include G-PP&E land. Similarly, prior to this Statement federal accounting standards required the expensing of stewardship land

(SL) for the period in which the acquisition cost was incurred and disclosures on the relationship between SL and the entity's mission, the entity's SL polices, major categories of SL use, and physical units of SL.

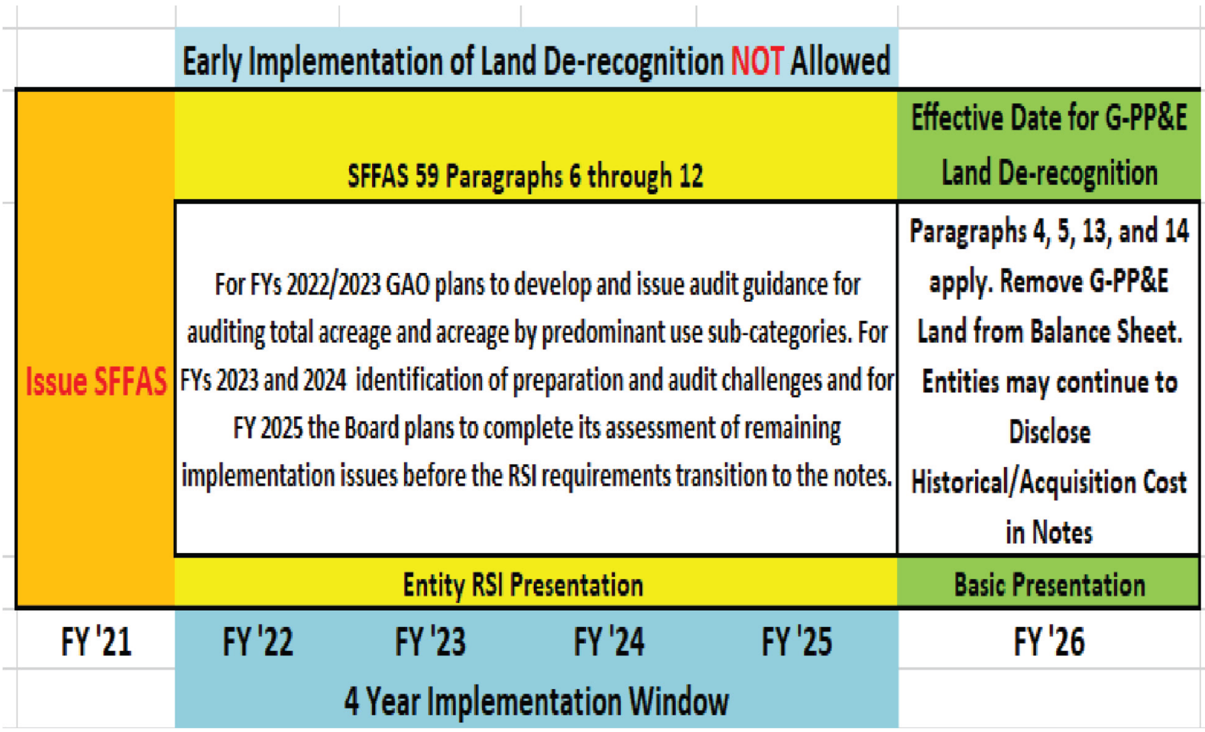
This Statement's principal requirements include:

- Reclassifying G-PP&E land and permanent land rights as a non-capitalized asset
- Referencing a note on the balance sheet that discloses information about G-PP&E land and permanent land rights without an asset dollar amount
- Reporting estimated acres of G-PP&E land and SL using three predominant use sub-categories
    - Conservation and preservation land
    - Operational land
    - Commercial use land
- Reporting estimated acres of land held for disposal or exchange
- Reporting land rights information, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights

Materiality

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial.[1] A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[1]Refer to Statement of Federal Financial Accounting Concepts 1, Objectives of Federal Financial Reporting, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.



Source: SFFAS 59, *Accounting and Reporting of Government Land*, paragraphs 15 and 16.

Table of Contents

Standards

Scope

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

2. This Statement amends the following guidance:[2]

    a. SFFAS 6, Accounting for Property, Plant, and Equipment

    b. SFFAS 29, Heritage Assets and Stewardship Land

    c. SFFAS 32, Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"

    d. SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

    e. SFFAS 42, Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32

    f. SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35[3]

3. This Statement does not change existing standards addressing Tribal land and land rights other than permanent land rights. In addition, this Statement does not apply to:

[2]Amendments to each of the Statements include, where applicable, (1) strikethrough deletions of existing text and (2) red, underlined additions. In some amendments, red underlining has been omitted for reading ease

[3]Amendments to SFFAS 50, a Statement which amended SFFAS 6, will be incorporated by reference as reflected in the SFFAS 6 amendments contained herein.

a. land held in trust or administered on behalf of Indian tribal governments or individual Indian land,

b. the Outer Continental Shelf (OCS).[4]

Amendments to SFFAS 6, Accounting for Property, Plant, and Equipment

4. This paragraph amends SFFAS 6 to clarify that land and permanent land rights are to remain in the general property, plant, and equipment (G-PP&E) category but are not to be capitalized.

   a. Paragraph 25 is amended as follows:

   25. Land and permanent land rights[28.1] acquired for or in connection with other general PP&E29 ~~shall be included in~~ are considered general PP&E but are not to be capitalized on the balance sheet. General PP&E land shall exclude (1) withdrawn public lands[29.1] or (2) land restricted for conservation, preservation, historical, or other like restrictions. Such land shall remain categorized as stewardship land (SL). ~~unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.. In some instances, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E~~.

   FN 28.1 - Land rights, such as easements or rights-of-way, that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

   FN 29 - "Acquired for or in connection with other general PP&E" is defined as 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.

   FN 29.1 - To the extent consistent with statutory authorities, an entity may withdraw public lands from the public domain for specific uses. For example,

[4]The term OCS refers to the seabed, subsoil and energy or mineral resources derived therefrom.

an entity may withdraw public land from sale, settlement, or recreational use to expand buffer zones for security or training needs.

b. Paragraph 26 is amended as follows:

26. **All g General PP&E**, other than land and permanent land rights, shall be recognized as an asset on the balance sheet and recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include: [no changes to the list that follows]

c. A paragraph and footnote is inserted following the heading "Expense Recognition" and before existing paragraph 35 as follows:

34A. The cost of acquiring general PP&E land and permanent land rights shall be recognized on the statement of net cost for the period in which the cost is incurred. The cost shall include all costs to prepare general PP&E land or a permanent land right for its intended use (for example, razing a building). In some cases, land may be acquired along with existing structures. If the structure is to be used in operations, the amount related to the structure shall be estimated and capitalized while the amount related to the land shall be expensed. If acquisition of the structure is incidental to the acquisition of the land and the structure is not intended to be used in operations, the cost of the entire acquisition shall be expensed. No amounts for general PP&E land or permanent land rights acquired through donation, devise,40.1 or judicial process shall be capitalized.

FN 40.1 - Acquisition of general PP&E can also occur due to legal devise or instrument, such as a will or a clause within a will that bequeaths property to an entity.

d. Paragraph 35 is amended as follows:

35. Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E,[41] except land and permanent land rights, shall be expensed as incurred ~~of unlimited duration~~.[42] [no changes to the list that follows]

FN 41 - Software [See SFFAS 10 for standards regarding internally developed software] and temporary land ~~[See SFFAS 10 for standard regarding internally~~

~~developed software]~~ rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. "Amortization" is applied to intangible assets in the same manner that depreciation is applied to general PP&E-tangible assets.

FN 42 - Temporary Lland rights, such as easements or rights-of-way, that are for a specified period of time or limited duration shall be depreciated or amortized over that time period.

e. Footnote 46 of paragraph 44 provides examples of major classes of assets. Footnote 46 is amended as follows:

FN 46 - "Major classes" of general PP&E shall be determined by the entity. Examples of major classes that are depreciated/amortized include buildings and structures, furniture and fixtures, equipment, and vehicles, ~~and land.~~

5. This paragraph amends paragraph 40 by providing guidance for establishing opening balances consistent with the amended reporting requirements for G-PP&E land. Because SFFAS 50 first amended this paragraph in SFFAS 6, SFFAS 50, paragraph 13 is also amended to conform to amended paragraph 40 shown below. There are no changes to paragraph 40.a-40.e.ii, 40.g, 40.h.i, and 40.i.i.

40.f. Alternative methods for ~~land and~~ temporary land rights. A reporting entity should choose among the following alternative methods for establishing an opening balance for ~~land and~~ temporary land rights. Because a reporting entity may have multiple component or subcomponent reporting entities selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

40.f.i. The reporting entity may exclude ~~land and~~ temporary land rights from the opening balance of general PP&E. If this alternative method ~~is~~ was applied, the reporting entity should prospectively capitalize and depreciate or amortize ~~expense future land and~~ temporary land rights ~~acquisitions~~ acquired, beginning in fiscal year 2026.

40.f.ii. Temporary Lland ~~and land~~ rights may be recognized in opening balances based on the provisions of the alternative valuation method (deemed cost) provided in paragraph 40.d.

40.h.ii. A component reporting entity electing to apply the provisions of paragraph 40.f.i. to ~~land and~~ temporary land rights should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. ~~A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures~~. In the event different alternative methods are applied to land and land rights (as permitted by paragraph 40.f.) by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

40.i.ii. When a component reporting entity elects to apply the provisions of paragraph

40.f.i. to ~~land and~~ temporary land rights, the U. S. government-wide financial statements should disclose this fact, the number of acres held at the end of each reporting period, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

6. This paragraph amends SFFAS 6 disclosure requirements.

a. Two paragraphs that add disclosure requirements applicable to G-PP&E land are inserted immediately following paragraph 45:

45A. The following disclosures[46.1] should be provided regarding G-PP&E land and permanent land rights:

a. A concise statement defining an entity's federal land, and explaining how land relates to the mission of the entity.

b. A brief description of the entity's policies for land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

c. Land and permanent land rights should be assigned to one of three sub-categories based on predominant use[46.1.a] and reported in estimated acres of land. The three sub-categories are commercial use land; conservation and preservation land; and operational land. Where land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land[46.1.b]. The following information should be presented by sub-category of land use:

i. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at the end of each reporting period for land and permanent land rights should be provided.

d. If applicable, the amount of estimated acres held for disposal or exchange and their predominant use. For purposes of this Statement, land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

e. Land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

FN 46.1 - Unless otherwise noted, disclosure requirements are limited to the G-PP&E land category and are not required for each of the three sub-categories of conservation and preservation land; operational land; and commercial use land.

FN 46.1a - Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

FN 46.1b - Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

45B. The financial statement balance sheet should reference a note that discloses information required at paragraph 45A (a through e) about G-PP&E

land and permanent land rights but no asset dollar amount should be shown. Existing display and disclosures46.2 should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

FN 46.2 - For G-PP&E land and land rights, existing disclosures are those that are in effect prior to the amendments contained in paragraph 45A. They include disclosures required by paragraph 40.h for those entities electing an alternative method for land and land rights and, if applicable, the minimum G-PP&E disclosure requirements as required by paragraph 45.

b. The disclosure requirements for the government-wide financial statements at paragraph 45 are amended as follows:

45. [No change to the list that precedes this text.]The ~~above~~ listed disclosure requirements for G-PP&E and G-PP&E land are not applicable to the U.S. Government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. Government-wide financial statements for these activities.

7. This paragraph amends SFFAS 6 by inserting additional definitions immediately after paragraph 20 as follows:

20A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.24.1 Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

FN 24.1 - Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

20B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

- concession arrangements;

- grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;
- and sales or land exchanges;
- leases;
- permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;
- forest product sales such as timber, or sales arising from national forests and grasslands; and/or
- public-private partnerships.

20C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

20D. <u>Operational land sub-category</u> includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

- <u>Military</u> functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.
- <u>Scientific</u> functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).
- <u>Nuclear</u> functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.

- Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

Amendments to SFFAS 29, Heritage Assets and Stewardship Land

8. This paragraph amends SFFAS 29 to clarify the definition of SL and references to general PP&E.

a. Paragraph 33 is amended as follows:

33. Stewardship Land ~~is~~ includes both public domain[14.1] and acquired land and land rights[15] owned by the Federal Government intended to be held indefinitely. ~~but not acquired for or in connection with[16] items of general PP&E~~. Examples of stewardship land include land reserved, managed, planned, used, or acquired for[16] ~~as forests and parks, and land used for wildlife and grazing~~.

a. forests and parks;

b. recreation and conservation;

c. wildlife habitat and grazing;

d. historic landmarks and/or the preservation of pre-historic and historic structures (those listed on or eligible for listing on the National Register of Historic Places);

e. multiple purpose ancillary revenue generating activity (for example, special use permits, mineral development activities, and timber production); and/or

f. buffer zones for security, flood management, and noise and view sheds.

FN 14.1 - Public domain land is land that was originally ceded to the United States by treaty, purchase, or conquest in contrast to acquired lands, which have been purchased by, given to, exchanged with, or transferred through condemnation proceedings to the federal government.

FN 15 - Land 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. Land rights such as easements or rights-of-way that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

a. FN 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. Land used or acquired for or in connection with items of general PP&E but meeting the definition of stewardship land should be classified as stewardship land.

b. Paragraph 35 is amended as follows:

35. Land and land rights ~~owned by the Federal Government and acquired for or in connection with items of~~ meeting the definition of general PP&E established in SFFAS 6, as amended, should be accounted for in accordance with SFFAS 6, as amended. ~~and reported as general PP&E~~.

c. Paragraph 39 is amended and footnote 20 rescinded as follows:

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, t~~ The transferring and recipient ~~entity~~ entities should properly adjust for estimated acres of land information ~~recognize a transfer-out of capitalized assets~~.[20]

a. FN 20 - Footnote rescinded by SFFAS ##. ~~SFFA7S , Accounting for Revenue and Other Financing Sources, par. 74 and par. 345-346~~.

9. This paragraph amends SFFAS 29 by rescinding paragraph 40.a-40.d.3 and replacing it with the disclosure requirements to require estimated acres of land and clarify the sub-categorization and reporting of land use. Sub-categorization should be based on predominant use using three new sub-categories. Further, disclosures should provide information regarding land held for disposal and transfers of land.[5]

Paragraph 40 is amended and a new paragraph 40A is added as follows:

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~~

[5]Unless otherwise noted, disclosure requirements are limited to the G-PP&E land category and are not required for each of the three sub-categories of conservation and preservation land; operational; and commercial use land.

~~shown. The note disclosure related to stewardship land should provide the following:~~ The following disclosures[21-21.1] should be provided for stewardship land and permanent land rights:

~~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~~

a. A concise statement defining an entity's federal land, and explaining how stewardship land relates to the mission of the entity.[21.2]

b. A brief description of the entity's policies for stewardship land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

c. Information of land use by sub-category. Stewardship land and permanent land rights should be assigned to one of three sub-categories based on predominant use21.1a and reported in estimated acres of land. The three sub-categories are commercial use land; conservation and preservation land; and operational land. Where stewardship land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land21.1b.

   1. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at the end of each reporting period for land and permanent land rights.

d. If applicable, the amount of estimated acres of land held for disposal or exchange and their predominant use. For purposes of this Statement, stewardship land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

e. Stewardship land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

FN 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.

FN 21.1 - Unless otherwise noted, disclosure requirements are limited to the stewardship land category and are not required for each of the three sub-categories of conservation and preservation land; operational land; and commercial use land.

FN 21.1a - Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

FN 21.1b - Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

40A. The financial statement balance sheet should reference a note that discloses information required at paragraph 40 (a through e) about Stewardship land and permanent land rights but no asset dollar amount should be shown. Existing disclosures21.2 should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

FN 21.2 - For stewardship land, existing disclosures are those required by paragraph 40, titled "Disclosures and Required Supplementary Information" that are being rescinded (40.a through 40.d.3) effective fiscal year 2026. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

10. This paragraph amends SFFAS 29 by inserting additional definitions immediately after paragraph 36 as follows:

36A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[17.1] Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation, or any combination thereof.

FN 17.1 - Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

36B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

a. concession arrangements;

b. grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;

c. land sales or land exchanges;

d. leases;

e. permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;

f. forest product sales such as timber, or sales arising from national forests and grasslands; and/or

g. public-private partnerships.

36C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

36D. Operational land sub-category includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

a. Military functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.

b. Scientific functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).

c. Nuclear functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.

d. Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

11. This paragraph amends paragraph 42 of SFFAS 29, which addresses the U.S. government-wide financial statement disclosures. Amendments will now require presentation of estimated acres of land by category. Paragraph 42 is amended and paragraph 42A is added as follows:

42. The U.S. Government-wide financial statement should include the following information: ~~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 including a general description of the federal government's land explaining how its federal land ~~it~~ relates to the mission of the Federal Government.

b. A ~~description~~ disclosure of the estimated acres of land by predominant use sub-categories and estimated acres of land held for disposal or exchange by 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~~, and estimated acres of land, ~~and physical units by major categories of stewardship land use~~.

42A. The U.S. Government-wide financial statement balance sheet should reference a note that discloses the information about stewardship land and land rights required by paragraph 42, but no asset dollar amounts should be shown. Existing disclosures[25.1] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

FN 25.1 - Existing disclosures at paragraph 42 are those which are in effect for reporting entities prior to the amendments contained at paragraphs 42 and 42A. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

Amendments to SFFAS 32, Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"

12. This paragraph amends SFFAS 32 to revise the government-wide disclosure requirements for property, plant, and equipment. Paragraph 23 is amended and paragraph 23A is added as follows:

23. The U.S. government-wide financial statements should include the following disclosures:

a. ~~a~~A broad description of PP&E,

b. For general PP&E land

i. A note on the balance sheet that discloses information FN1 about general PP&E land and permanent land rights which includes:

1. A concise statement including a general description of the federal government's land explaining how its federal land relates to the mission of the Federal government.

2. A disclosure of estimated acres by predominant use sub-categories and estimated acres of land held for disposal or exchange by the Federal government

c. ~~b.~~ ~~t~~The cost (excluding land and permanent land rights), associated accumulated depreciation, and book value by major class, and

d. ~~c.~~ ~~a~~A general reference to agency ~~component entity~~ reports for additional information about general PP&E and general PP&E land~~.~~

23A. The balance sheet should reference a note that discloses the information[2.1] about general PP&E land and permanent land rights required by paragraph 23, but no asset dollar amounts should be shown. Existing display and disclosures[2.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

FN 2.1 - Additionally, such information may include a description of the different uses of land managed by the entity, its predominant activities, condition information, and policy initiatives in effect during the reporting period.

FN 2.2 - Existing disclosures at paragraph 23 are those which are in effect for government-wide reporting prior to the amendments contained at paragraph 23A.

Amendments to SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

13. This paragraph amends SFFAS 7 to clarify guidance regarding transfers and donations of land.

a. Footnote 14 at paragraph 62, which discusses revenue arising from donations, should include a reference to the amended SFFAS 6, paragraph 34A under the heading "Expense Recognition." Footnote 14 is amended as follows:

FN14 - For the recognition criteria for donated property, plant, and equipment, see SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 30, 34A, 62, and 71.

b. Paragraph 258 discusses non-exchange transactions with the public, specifically donations. This should include G-PP&E land. Paragraph 258 is amended as follows:

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.51 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 general PP&E land, permanent land rights, and stewardship property, plant, and equipment) is therefore a nonexchange revenue.

c. Paragraph 259 discusses non-exchange transactions with the public, specifically donations. This should include G-PP&E land. In addition, this paragraph is amended to conform to paragraph 9.d. of SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, which rescinded the category "federal mission property, plant, and equipment." Paragraph 259 is amended as follows:

259. The exceptions are for donations of assets that are expensed rather than capitalized. These include general PP&E land and permanent land rights, 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.52 Correspondingly, no revenue is recognized for such donations.

d. Paragraph 296 and footnote 62 discuss sales of property, plant, and equipment. This should include G-PP&E land and permanent land rights. In addition, footnote 62 is amended to conform to SFFAS 23, paragraph 9.d, which rescinded the category "federal mission property, plant, and equipment." Paragraph 296 and footnote 62 are amended as follows:

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 general PP&E land, permanent land rights, or stewardship PP&E, for which the entire cost is expensed when the asset is purchased.62

FN 62 - SFFAS 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 other than land and permanent land rights is capitalized and recognized on the balance sheet; general PP&E land, permanent land rights, and stewardship PP&E ~~is~~ are expensed and thus ~~has~~ have no book value. (Stewardship PP&E is presented in a stewardship statement.)

e. Paragraph 345 discusses intragovernmental transfers of PP&E. This should include G-PP&E land in the requirement. Paragraph 345 is amended as follows:

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~~e.g., general PP&E land and stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as either general PP&E land (including permanent land rights) or 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.

f. Paragraph 346 discusses intragovernmental transfers of PP&E classified as G-PP&E by the transferor but as SL by the recipient. This should not include the de-recognition requirement for G-PP&E land and permanent land rights. Paragraph 346 is amended as follows:

346. However, if the asset that is transferred was classified as general PP&E (excluding non-capitalized general PP&E land and permanent land rights) 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.

g. Paragraph 358 discusses transfers of PP&E. This should include G-PP&E. Paragraph 358 is amended as follows:

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., general PP&E land [including permanent land rights] and stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as either general PP&E land (including permanent land rights) or 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.

h. Paragraph 361 discusses donations of PP&E. This should include G-PP&E. In addition, this paragraph is amended to conform to SFFAS 23, paragraph 9.d, which rescinded the category "federal mission property, plant, and equipment." Paragraph 361 is amended as follows:

361. Donation of property, plant, and equipment: types that are expensed.-The acquisition costs of general PP&E land (including permanent land rights), heritage assets, and stewardship land ~~property, plant, and equipment (PP&E) is~~ are 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.81 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.

Amendments to SFFAS 42, Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, And 32

14. Paragraphs 13, 15.d, and 15.e are amended to ensure that deferred maintenance and repair (DM&R) information is reported in non-capitalized G-PP&E land.

    a. Paragraph 13 is amended as follows:

    13. DM&R should be measured and reported for capitalized general PP&E, non-capitalized general PP&E land (to include permanent land rights), and stewardship PP&E. DM&R also may be measured and reported for general PP&E other than land and permanent land rights that is non-capitalized or fully depreciated ~~general PP&E~~. DM&R should include funded maintenance and repairs (M&R) that have been delayed for a future period as well as unfunded M&R. DM&R on inactive and/or excess PP&E should be included to the extent that it is required to maintain inactive or excess PP&E in acceptable condition. For example, inactive PP&E may be maintained or repaired either to comply with existing laws and regulations, or to preserve the value of PP&E pending disposal.

    b. Paragraph 15 is amended as follows:

    15. At a minimum, the following information should be presented as required supplementary information (RSI) for all PP&E (each category established in SFFAS 6, as amended, should be included) regardless of the measurement method chosen.

    Qualitative **(No edits for items 15.a-15.c or 15.f-15.g.)**

    d. Whether DM&R relates solely to capitalized general PP&E and non-capitalized general PP&E land, stewardship PP&E, or also to amounts relating to non-capitalized or fully depreciated general PP&E

    e. Capitalized and non-capitalized general PP&E, and non-capitalized heritage assets, and stewardship land for which management does not measure and/or report DM&R and the rationale for the exclusion

Effective Date

15. The scope of this Statement (paragraphs 1-3) is effective for reporting periods beginning after September 30, 2021. The information required at paragraphs 6 and 7 (G-PP&E land), paragraphs 8-10 (stewardship land), paragraph 11 (government-wide stewardship land),

and paragraph 12 (government-wide G-PP&E land) should be presented as RSI for fiscal years 2022 through 2025 and transition to note disclosures in fiscal year 2026. Asset dollar amounts for G-PP&E land and permanent land rights should remain on the balance sheet along with existing disclosures through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures and paragraphs 4, 5, 13, and 14 become effective. Existing display and disclosure (balance sheet reference) for stewardship land should continue through fiscal year 2025 until they are superseded by the requirements at Paragraphs 8-10 beginning in fiscal year 2026.

16. It is the Federal Accounting Standards Advisory Board's (FASAB or "the Board") intent that the information required by this Statement transition to basic information in fiscal year 2026 after being reported as RSI for a period of four years. Prior to the conclusion of the four-year RSI period, the Board plans to make any necessary adjustments to facilitate the transition to basic information. Early adoption is not permitted.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting, chapter 7, titled Materiality*, for a detailed discussion of the materiality concepts.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses the 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 and not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

The ensuing paragraphs, beginning with A1 "Project History," discuss in detail the Board's basis for conclusions and agreement with those in the financial reporting community, who expressed the need for uniform accounting guidance that addressed the lack of relevant, reliable, and consistent historical cost information and the application of inconsistent measurement approaches.

Prior to the issuance of this Statement, federal accounting standards required the capitalization of the historical cost of G-PP&E land and disclosures regarding restrictions on the use or convertibility of G-PP&E to include G-PP&E land. Similarly, prior to this Statement federal accounting standards required the expensing of SL for the period in which the acquisition cost was incurred and disclosures on the relationship between SL and the entity's mission, the entity's SL policies, major categories of SL use, and physical units of SL.

The Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations such as passage of time and inflation make historical cost less relevant to users. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measurements were used to recognize land on the balance sheet.

Project History

A1. The Board added the accounting and reporting of government land project in February 2016 during its three-year plan review. The Board agreed that the project was necessary to address significant differences in accounting treatment and implementation issues arising from SFFAS 6; SFFAS 7;[6] SFFAS 29; and SFFAS 50,. The Board's most notable concerns included the following:

a. There is limited value in historical/acquisition cost information for capitalized land, given that such information may lose relevance over time due to general inflation, general land appreciation, and environmental harm.

b. There is inconsistent reporting of G-PP&E land arising from differences in how opening balances are valued, as permitted by SFFAS 50. That is, reporting entities may exclude land and land rights from opening balances.

c. There is incomplete reporting on land where neither the total cost of land nor the total physical quantity of land is consistently reported.

d. Some information that is currently reported does not adequately satisfy FASAB's reporting objectives and qualitative characteristics. For example, physical unit grouping (such as number of parks) is not contributing to either the operating performance or stewardship objectives.

e. There are inconsistencies between reporting of SL and G-PP&E land.

A2. SFFAS 6 requires that land and land rights acquired for or in connection with other G-PP&E be capitalized at the cost incurred to bring the assets to a form and condition suitable for use. "Acquired for or in connection with other G-PP&E" is defined as land acquired with the intent to construct G-PP&E. It also includes land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the G-PP&E's common grounds.

A3. By contrast, SFFAS 29 defines "stewardship land" as land (including land rights) other than land acquired for or in connection with other G-PP&E. It does not require balance sheet recognition but, instead, requires expensing the land cost when acquired and disclosures regarding policies for land management, categories of land, and physical unit information.

[6]SFFAS 7 requires that donations made to the government by a nonfederal entity, to include nonfinancial resources such as land or buildings, be recognized (for those inflows of resources that meet recognition criteria for assets) and measured at the estimated fair value of the contribution.

A4. Most recently, SFFAS 50 allows reporting entities to apply alternative methods in establishing opening balances for G-PP&E. Concerning land, the alternative methods include using deemed cost to establish opening balances of G-PP&E land and land rights or excluding them from opening balances with disclosure of acres of land and expensing of future acquisitions.

A5. The above requirements for both G-PP&E land and SL result in significant differences in accounting treatment for federal land. Specifically, land acquired during the nation's formation may be used in connection with other general PP&E, but it may not (1) have identifiable acquisition costs, (2) be valued at all, or (3) be valued in a way that is similar to G-PP&E land and land rights acquired for similar purposes. G-PP&E only includes land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E. The result is disparate treatment of G-PP&E land. Furthermore, SL, which accounts for an estimated 97 percent of all land managed by the federal government, is expensed when acquired, not capitalized, leading to yet another significant difference in land treatment.

A6. To the extent practical, members requested that future guidance consistently treat all federal land the same regardless of its G-PP&E land or SL distinction. The Board directed staff to identify available options, along with associated benefits and drawbacks. In particular, the Board asked staff to (1) consider user information needs; (2) explore and identify the information agencies use to manage land; (3) identify types of information, such as acres of land, that would help demonstrate the government's stewardship and accountability over federal land; (4) address whether land held for disposal (for example, sale, public-private partnerships, donated to state and local governments) should be valued; and (5) consider whether a uniform land accounting policy is a viable option given initial agency and task force feedback that current land categorizations of SL and G-PP&E land be retained.

A7. To assist in evaluating options for enhancing the consistency[7] among existing accounting standards, entity-to-entity comparability, and relevance of information regarding land, the Board established a task force consisting of representation from federal agencies, the commercial sector, and citizen users.[8] The task force held meetings between June 2016 and April 2017. Participants came from diverse disciplines, such as accounting, auditing, civil engineering, financial reporting, business consulting, and program management. The

[7]Criticism over consistency has arisen because current standards differ in how entities report land and land rights; for example, G-PP&E land is capitalized, whereas SL is not. As such, some believe that inconsistent accounting standards lead to reporting that is not comparable and obscures how a user can assess an entity's performance over land management.

[8]Please refer to Appendix E for the identification of task force participants.

majority of participants agreed that, among federal report preparers and users, there is significant interest in how agencies manage land on behalf of the public and how this information is communicated in financial statements.

A8. Due to the divergent views among task force participants, principally between preparers and users, reaching consensus on the major issues proved challenging. To best meet the project goals and objectives, staff, in addition to engaging in task force discussions, initiated fact-finding meetings with three land-holding agencies: the Department of Defense, the Department of Energy, and the Department of the Interior. Notably, retaining the current land categorizations of SL and G-PP&E land was the one area in which preparers and users unanimously agreed.

Development of the Exposure Draft (ED)

A9. The Board considered its conceptual framework and the divergent task force views in developing its proposal for reporting on land. The Board considered financial and non-financial information (NFI) land reporting options in light of the reporting objectives, qualitative characteristics, cost-benefit considerations, and presentation formats (basic or required supplementary information [RSI]).

It is important to note that a major consideration throughout the Board's deliberations was the guidance in Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. Specifically, paragraph 9 states:

> An item that meets the appropriate definition of an element is an asset, liability, revenue, or expense, even if it is not recognized in the accrual-basis financial statements because, for example, it is not measurable or its amount is not material. Unrecognized elements are candidates for disclosure in the notes to financial statements or as supplementary information.

Members agreed with those in the financial reporting community who noted the importance of having consistent accounting standards and agreed that there were limitations inherent in historical cost valuations. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measures were used to recognize land on the balance sheet.

To address this, the Board decided to remove such amounts from the balance sheet, expense future acquisitions of land and permanent land rights, treat temporary land rights similarly to leases, and require NFI (number of acres) disclosures. The SFFAS 29 requirement to exclusively use NFI to report federal SL provides a precedent for this approach. A task force analysis noted that approximately 97.0% (or 603.7 million acres) of all land managed by the federal government is SL, which, under SFFAS 29 is reported as NFI. Furthermore, the Board notes that a portion of the remaining ~3.0% (~19.6 million acres) of land currently classified as G-PP&E land is withdrawn land from the public domain. Had this land not been withdrawn, it would be classified as SL and been subject to the SFFAS 29 requirements for non-recognition and disclosure as NFI.

Due to concerns that the stewardship and operating performance reporting objectives and qualitative characteristics, such as relevance and comparability, were not being met, the Board proposed expensing land and permanent land rights and disclosing acres in a note. Additional key conceptual points leading to the Board's proposal include:

a. Historical cost of land and permanent land rights is not useful to the majority of users for assessing stewardship[9] or entity operating performance primarily due to the static nature of the reported dollars (that is, not accounting for inflation or changes in value).[10] In addition, historical cost of land and permanent land rights is not relevant for decision makers.[11]

   i. Having considered the input of the task force, exposure draft (ED) respondents, and subject matter experts, the Board also concluded that, although historical cost information of G-PP&E land may be reliable for certain agencies, such information is not reliable at the government-wide level. This is because some agency historical cost records are incomplete or non-existent.

   ii. Increasing the usefulness and relevance of information can be achieved through the selective use of a measurement attribute (basis) that best reflects the measurable characteristic of an asset or liability. Measurement attributes that are commonly used to assign monetary amounts to financial statement elements, such as assets and liabilities, like land include: fair value, settlement amount, replacement cost, value in use, and fulfillment cost. However, alternative measurement approaches, such as those that are non-financial in nature, can be used to best reflect an element's characteristics. To that end, during deliberations of SFFAS 29 and SFFAS

[9]SFFAC 1, *Objectives of Federal Financial Reporting*, par. 134-145.

[10]SFFAC 1, par. 122-133.

[11]SFFAC 1, par. 161 and SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par.7.

50, the Board concluded that number of acres best reflects and communicates land's measurable characteristic, increasing relevance and information usefulness.

b. Prior analysis of user needs, as confirmed by the land task force, revealed that presenting the historical cost of land in the financial statements is of limited value to users. Although users would often obtain information from other publicly available sources, these other sources do not reflect audited or verified information. The need for audited information was identified by the majority of task force participants.[12]

   i. In addressing this limitation, the Board concluded that reclassifying G-PP&E land and permanent land rights as a non-capitalized asset, expensing future acquisitions, and increasing disclosure requirements of non-financial land information is more informative to users and best satisfies the Board's stewardship and operating performance reporting objectives. This decision is consistent with SFFAS 50, which permits reporting entities to not capitalize G-PP&E land and land rights under certain conditions.

   ii. The Board also concluded that if the reporting entity believes that information about the cost of G-PP&E land and permanent land rights is critical to the understanding of the financial statements, such information may be presented in the note disclosure at the reporting entity's discretion without explicit guidance to do so.

c. Fair value reporting is not cost-beneficial given the vast holdings of land. This is primarily due to the impracticalities associated with valuing land, absent conditions such as demographically comparable sales, active markets or willing buyers, and estimations of the environmental liabilities associated with certain federal land.[13]

   i. Citizen users on the task force and some ED respondents noted the benefit of fair value estimates of government federal land. They generally noted that, to assess an entity's stewardship and operating performance, fair value estimates of land parcels would help users assess whether such land should be either sold or transferred to state/local governments. However, the Board concluded that fair valuing land parcels would be prohibitive given the impracticalities and costs. The Board concluded, instead, that number of acres would be more informative to the general public, Congress, and agency management.

[12] SFFAC 1, par. 158-159.

[13] SFFAC 2, *Entity and Display*, par. 73E.g. and SFFAC 5, par. 7.

d. Acres provide a transparent, understandable, and comparable measure across the federal government and allow users to consider how much land was held for particular purposes (operating performance) and how the amount of land held changed over time (stewardship).[14]

   i. The Board realizes that some respondents believe the use of NFI, such as number of acres, to satisfy reporting objectives is relatively unprecedented. However, as previously noted, SFFAS 29 adopted the use of NFI (that is physical unit reporting) to satisfy both reporting objectives and the qualitative characteristics of information in federal reporting. The Board further notes that to address any potential audit challenges related to NFI, the requirements of this Statement are subject to a phased implementation schedule. This will enable the Board to evaluate implementation and identify and address any issues as they arise.

e. As discussed in paragraph A9.a.ii, by moving all land to the measurement of acres, the Board concluded that financial statement reporting will better achieve the qualitative characteristics of consistency and comparability. Additionally, moving away from the current mixed measurement attribute model to a uniform acre model increases the qualitative characteristic of understandability. Finally, advancements in geospatial technology facilitate measuring acres more accurately, which contributes to the qualitative characteristic of reliability. The Board concluded that such advancements, assisted by an RSI transition period, will facilitate development of reliable acre information suitable for presentation as basic information.

f. The NFI relates to a significant asset (an element of financial reporting) that interests a wide audience. Furthermore, it has a high degree of importance and criteria for reliably and consistently measuring acres, making the information appropriate for note disclosure.[15]

   i. As previously noted, G-PP&E land represents approximately ~3.0% (~19.6 million acres) of land-some of which has been withdrawn from the public domain. As such, were it not withdrawn, such land would have to comply with the SFFAS 29 requirements of non-recognition and use of NFI.

[14]SFFAC 1, par 156, SFFAC 2, par. 73E.e., and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,* par. 9

[15]SFFAC 2, par. 73E.

g. The selection of an appropriate measurement attribute in specific circumstances should be based on the reporting objectives, qualitative characteristics, and cost-benefit constraints applicable to the financial information in question.[16]

   i. The Board concluded that attempting to apply a monetary measurement attribute to the government's vast holdings of land would fail to meet cost-benefit considerations, as well as such key qualitative characteristics as understandability, relevance, and comparability. The Board concluded that reclassifying previously capitalized G-PP&E land costs as expenses accompanied by disclosure of acres would best meet the reporting objectives and qualitative characteristics in a cost beneficial manner.

h. In conclusion, the Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations, such as passage of time and inflation, changes in economics (for example, base closures, government relocations), demographic or population shifts (for example, shifting veteran populations, rural development activities), and even climate related issues (for example, coastal floods and forest fires), make it impractical and cost prohibitive to annually corroborate or appraise over 622 million acres. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency while either avoiding or at least significantly minimizing burden and reporting costs that would otherwise be borne if traditional (that is, monetary based) valuation methods were used for balance sheet recognition.

Summary of Outreach Efforts and Responses

A10. The ED was issued April 30, 2018, with comments requested by July 30, 2018. Upon release of the ED, notices and press releases went to the following: the *Federal Register, FASAB newsletter, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive*, and the *CPA Letter*, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, members of both the Federal Real Property Council and Federal Facilities Council, and committees of professional associations generally commenting on EDs in the past.

A11. This broad announcement was followed by electronic mailings of the ED to the following relevant congressional committees: Senate Energy and Natural Resources and House Natural Resources.

[16]SFFAC 5, par. 8.

A12. FASAB received a total of 18 responses, which are summarized in the following table by respondent type. The majority of respondents generally agreed with the Board's proposal to reclassify G-PP&E land and permanent land rights as a non-capitalized asset and to issue related disclosure requirements. However, some respondents (1) expressed concerns with what they viewed as a departure from universally accepted accounting principles and (2) identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

Summary of Respondent Types to the ED

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	**13**	**-0-**	**13**
Users, academics, others	**-0-**	**3**	**3**
Auditors	**1**	**1**	**2**
Total	**14**	**4**	**18**

A13. At the August 2018 Board meeting, the Board decided to extend an invitation to (1) the ED respondents to discuss with the Board their comments on the ED and provide clarification of their responses and (2) additional subject matter experts comprising federal land managers, the audit community, and other interested parties to share their expert perspectives regarding land reporting. Eight ED respondents accepted the Board's invitation and clarified their comments at the October 2018 Board meeting. Five subject matter experts shared their views at the October 2018 Board meeting on a variety of matters related to the land ED.

A14. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised.

A15. Respondents who agreed with the Board's proposal to reclassify G-PP&E land and permanent land rights noted:

a. The geographic information system (GIS) can be readily adopted to comply with the reporting requirements for acres and satisfy most auditor concerns.

b. Valuation of land is too costly and questionable in light of environmental liabilities.

c. There will be little financial statement impact to expensing future acquisitions of G-PP&E land and permanent land rights.

d. However, respondents who agreed with reclassifying G-PP&E land and permanent land rights also raised key concerns: (1) the incomparability of physical units creates the potential for inconsistent application within agencies, (2) not all agencies have consistent GIS policies throughout their bureaus, and (3) system changes to policies and information technology databases/applications will require additional time and effort to implement.

A16. Respondents who disagreed with reclassifying G-PP&E land and permanent land rights noted the following concerns:

a. G-PP&E land is an asset that should remain on the balance sheet so as not to distort financial reporting.

b. The Board's proposal veers from its conceptual framework by over-emphasizing one asset category over all the others.

c. separating a land value from a building value is complicated,

d. The ED leads to duplicative reporting because G-PP&E acres are presented in the Federal Real Property Profile as well as in performance reports.

e. Audit precision and related burdens are problematic because there are no internal controls over acre information systems.

f. The effect of expensing G-PP&E acquisitions in the statement of net cost will be significant.

g. Physical units are not meaningful, and the information already exists in other reports.

h. Many implementation issues will necessitate additional implementation guidance.

i. Some rate-setting entities use and require historical cost information concerning land.

j. Some agency GIS personnel have existing backlogs that take precedent, such as land disputes that will not allow them to satisfactorily support reporting and audit initiatives.

A17. Subject matter experts provided their views on the proposed land ED, which are summarized as follows:

Comments opposing the ED include the following: Data collection should be commensurate with user needs. In this case, the cost of aggregating land information, given the de-centralized manner in which it is stored, may be cost prohibitive. Using the existing Public Land Statistics report for financial reporting purposes, as contemplated by the ED, would require a potentially cost-prohibitive investment of additional resources. The Public Land Statistics are designed for the general public, not financial reporting purposes. SFFAS 50 provides sufficient reporting flexibilities, making the ED unnecessary. Because land benefits future periods, it should remain on the balance sheet; excluding it will understate the financial position. It is unclear how this proposal would improve financial management, which is the intent behind the CFO Act and the Federal Financial Management Improvement Act.

Comments that were neither in support of nor opposed to the ED include the following: Physical unit information, such as acres, needs context to be useful. Interior bureaus are working to improve the Protected Area Database of the United States and the Surface Management Area data. Agencies should be allowed flexibility to explain their unique missions and land responsibilities. Without clearer materiality guidance, acres or other NFI may be more suitable for RSI. Consideration should be given to presentation formats other than disclosures. The use of agreed upon procedures, rather than audits, should be considered for land information. The preparer transition period should not be underestimated; it could take multiple years for auditors to gain comfort. Performance information, which is not contemplated by the ED, when combined with cost information would allow an assessment of effectiveness and efficiency and would be valuable to users.

A18. Regarding the concern that expensing land and permanent land rights would distort financial reporting, the Board notes that presentation options exist that could mitigate potential distortions to an entity's operating costs brought about by expensing land and permanent land rights acquisitions. For example, material acquisitions might be presented separately as a major program or as costs not assigned to programs. Nevertheless in its re-deliberations of the land ED, the Board concluded that the respondent comments and subject matter expert views indicated a need to reconsider certain disclosure requirements, the proposed implementation approach, and the related timeline. As a result, the following changes were made to the proposed land ED requirements:

a. Deleting the physical unit disclosure requirements

b. Deleting the requirement to reference DM&R (RSI) presentations

c. Limiting the first two disclosure requirements (that is, how land relates to the entity's mission and an entity's policies over land) to the primary categories of SL and G-PP&E land and not to the sub-categories

d. Simplifying the "estimated acres" reporting requirement by only requiring that beginning and ending balances be provided

e. Clarifying that "acres of land held for disposal or exchange" applies only to land conveyed to non-federal entities

f. Clarifying the type of information to be disclosed at the government-wide level

A19. Concerning the proposed implementation approach and related timeline, the Board agreed that the final Statement should (1) require a specific transition date from RSI to note disclosure, (2) extend the time required for the transition so that the Board would have an opportunity to modify guidance if necessary, and (3) not permit early implementation.

User Needs

A20. Respondents generally agreed that providing "estimated acres of land" would help ensure that user needs are met. One respondent noted that the information should be first designated as RSI and not moved to basic information until there is sufficient confidence in its reliability. Some respondents noted that to focus only on NFI may not be appropriate unless there is some financial information to which NFI relates.

A21. As the Board noted in its ED, users want understandable financial information that is verified or audited so that they can participate in the democratic process and engage in discussions about the nation's finances. Specific to land, users desire transparency (for example, fair value estimates or land measured by parcel size or acre) over how much land an entity manages and its uses. As such, the Board concluded that user needs are best met with information that is relevant, reliable, and understandable while meeting cost-benefit considerations. To that end, the Board maintains its position that historical cost information, although reliable in most cases, is not relevant to most users. Given the cost-benefit constraints, number of estimated acres is best suited in meeting user needs.

A22. Moreover, to increase the reliability of the reporting of acres, the Board agrees with those respondents supporting that (1) acreage be treated as basic information (note disclosure) and (2) an RSI transition period be established prior to transitioning to basic note disclosure. Concerning inclusion of financial information with which acres should relate, the Board notes that entities are free to disclose the cost of G-PP&E land and permanent land rights in the notes. Nevertheless, consistent with SL requirements, the Board has modified its proposal to now require entities with G-PP&E land and permanent land rights to reference a note on the balance sheet that discloses information about G-PP&E land and permanent land rights, but no asset dollar amount should be shown.

Retaining Property, Plant, and Equipment (PP&E) Categories

A23. The majority of respondents agreed with the Board's proposal to retain the G-PP&E land and SL categories.[17] SFFAS 6 establishes three categories of PP&E: (1) G-PP&E, (2) heritage assets, and (3) SL. It is important to note that categorizing land in accordance with SFFAS 6 is predicated on an entity's <u>intended use</u> of the land at acquisition and not necessarily how the land is actually used during the reporting period. Due to concerns over inconsistent accounting and reporting of federal land, the Board established three sub-categories based on how entities in fact use the land they manage. The three land-use sub-categories are (1) conservation and preservation land; (2) operational land; and (3) commercial use land. Refer to Appendix B for illustrations concerning the three sub-categories. Therefore, users are provided with both the entity's intended use of the land and permanent land rights (that is, primary categories of SL or G-PP&E land) as well as their actual use (predicated on predominant use by sub-category) during the reporting period.

Land Use - Categorizing and Sub-categorizing Land Consistently

A24. To improve the comparability of reporting federal land and the uniformity of disclosures, the Board proposed three sub-categories predicated on land use for both G-PP&E land and SL: (1) conservation and preservation land; (2) operational land; and (3) commercial use land. Concerning the sub-categories, respondents noted that (1) the entity should determine in which sub-category the acres are placed and should not be required to apportion among the sub-categories and (2) the three sub-category definitions appear after the proposed definition of acres of land held for disposal or exchange, making it appear that there are four unique sub-categories rather than three.

A25. The Board notes that the ED explicitly stated that the sub-categorizations would be predicated on predominant use. Predominant use is not a new requirement and was first introduced in SFFAS 29, which was issued on July 7, 2005. Furthermore, concerning G-

[17]The Board proposed retaining these two categories primarily because (1) G-PP&E land and stewardship land are acquired for two separate, distinct purposes, (2) these two land types are often maintained and used in completely different ways, (3) keeping the two types of land separate promotes transparency, consistency, and understandability and (4) eliminating the distinction between the two land types could have adverse consequences to legislative requirements and/or budget appropriations.

PP&E land, the General Service Administration's Federal Real Property Council has established predominant use reporting definitions and requirements since 2005.

A26. It is important to note that this Statement continues the practice in SFFAS 29 that provides entities with flexibility in determining predominant use. For example, in cases where land, including permanent land rights, has multiple uses, none of which is predominant, the entity may attempt to sub-categorize such land. In so doing, entities may find it practicable to apportion the estimated acres among the sub-categories. Paragraph A35 provides additional information on determining the level of aggregation and assignment of land and permanent land rights used to determine predominant use To be considered a predominant use, land activities or uses are generally not incidental but are normal and recurring in connection to the entity's mission. Nevertheless, the Board recognizes that future guidance concerning predominant use may be required.

A27. Regarding acres of land held for disposal or exchange, defined at paragraph 20.A., the Board notes that (1) it did not intend to create a fourth sub-category and that narrative presentation or disclosure of said acres is sufficient to meet the Statement's requirements, (2) entities are free to develop graphical or tabular illustrations, and (3) examples found at Appendix B are intended to aid in the application of these key provisions and not illustrate compliance with all of the proposed disclosure requirements.

Developing Uniform Land Disclosure Requirements

A28. Although the majority of respondents agreed with the Board's proposed disclosure requirements, some respondents noted that preparer burden and audit efforts would increase. Examples cited include:

a. Financial reporting systems are not currently designed to capture the newly required information. Acreage information is not expected to be recorded in transaction-based financial accounting and reporting systems. Moreover, this Statement does not require entities to integrate or link property (land) management systems to financial systems solely for the purpose of applying these standards.

b. Agencies have spent considerable resources to ensure compliance and auditability; adding more data elements to the reporting requirements contributes to disclosure overload and exacerbates the existing cost burden.

c. However, some respondents also believed that increases to preparer burden and audit efforts after initial implementation would be temporary. In response to the Board's implementation timeline, more fully discussed below, the Government Accountability Office may issue auditor guidance and the Office of Management and Budget will update its audit bulletin, as necessary.

A29. In connection with the Board's position to reclassify G-PP&E land and permanent land rights as a non-capitalized asset, the Board concluded that developing uniform accounting and reporting requirements across all land categories not only satisfactorily addresses longstanding issues concerning the reporting over land, but also increases informational value to users. Many of the disclosure requirements have been taken from existing requirements contained in SFFAS 29 (for example, disclosure of how land relates to an entity's mission and its policies over land). Moreover, the Board considered respondent comments as well as interested party views in developing the final disclosure requirements. As a result, the revised disclosure requirements reflect the following changes:

a. Eliminating physical unit disclosure requirements

b. Eliminating the DM&R reference requirement

c. Limiting the first two disclosure requirements (that is, how land relates to the entity's mission and an entity's policies over land) to the primary categories of SL and G-PP&E land and not to the sub-categories

d. Simplifying the requirement to report estimated number of acres by only requiring the beginning and ending balances be presented

e. Clarifying that "acres of land held for disposal or exchange" applies only to land satisfying legislative disposal authority requirements intended to be conveyed to non-federal entities

f. Clarifying that the Board does not require the reporting of Tribal land held in trust. As an amending Statement, the Board considered inclusion of lands held in trust but elected to continue the long-standing exclusion of such lands due to their fiduciary nature.

g. Clarifying that the Board does not require the reporting of the Outer Continental Shelf (OCS)[18] lands because they do not meet FASAB's definition of land as contained in its handbook, at Appendix E. The definition reads as follows:

> 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.

[18]The Board notes that it interprets the term OCS to include the seabed, subsoil and energy or mineral resources derived therefrom.

Nevertheless, if an entity manages material amounts of OCS acreage, the Board believes that this fact should be disclosed.

h. Clarifying the type of information to be disclosed at the government-wide level

The Board believes that the revised disclosure requirements coupled with a graduated phase-in approach satisfactorily addresses concerns related to preparer burden and audit effort.

Definitions

A30. The majority of respondents agreed with the proposed definitions. As previously noted, the task force recommended that the current land categorizations of SL and G-PP&E land be retained. Pursuant to respondent comments, the Board clarified that "acres of land held for disposal or exchange" applies only to land satisfying legislative disposal authority requirements intended to be conveyed to non-federal entities. Concerning land held for disposal or exchange, disposal authorities are generally designed to permit entities to dispose of or exchange land that is no longer required for a federal purpose. Disposal authority might authorize an entity to sell or lease federal land to a state or municipal government or non-profit entity for educational or community development purposes. Additionally, disposal authority might authorize an entity to exchange federal land for non-federal land. Disposal includes conveyances of federal land not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

Land Rights

A31. Prior to issuing its ED, the Board concluded that temporary land rights (that is, other than permanent land rights) would not be subject to the new requirements of this Statement. The rationale for excluding temporary land rights was based on the Board's belief that (1) such land rights are intangible assets and should be addressed in an Intangibles project and (2) the cost of separating such land rights from the underlying asset would be prohibitive. Therefore, in SFFAS 6 the Board provided for the recognition of land rights based on the expected service life of the land rights. Specifically, where land rights are for a limited or finite period of time (that is, temporary), the Board provided for amortization/ depreciation of the cost to acquire and maintain such rights. The land rights considered permanent are capitalized along with land. SFFAS 50 provided alternative methods for establishing opening balances. Specifically, paragraph 13 (which amended par. 40 of SFFAS 6) provides reporting entities that met the SFFAS 50 criteria to apply the option to either (1) exclude both land and (all) land rights from the opening balance of G-PP&E or (2) recognize land and land rights in opening balances based on the provisions of the alternative valuation method (deemed cost).

A32. In its ED, the Board proposed to treat land rights with an unlimited or infinite period of time (that is, permanent) consistent with the proposed requirements regarding land acquisitions (that is, expensing) and to continue treating those temporary land rights consistent with SFFAS 6. During re-deliberations and considering respondent comments specific to land rights, the Board reconsidered its proposed amendment allowing entities electing to exclude land and land rights (from the opening balance of G- PP&E pursuant to SFFAS 50) to expense future acquisitions of temporary land rights. As a result, the Board concluded that those entities electing to exclude land and land rights from their opening balances should capitalize and depreciate/amortize temporary land rights prospectively. The Board concluded that this aforementioned requirement increases comparability and consistency by providing a uniform accounting practice relative to all land rights. Furthermore, the Board notes that, unlike permanent land rights, temporary land rights are limited in duration and have a definite useful service life or economic life. As such, the Board believes that accrual based financial statements benefit from the allocation of costs between accounting periods.

Requests for Exceptions to De-recognition

A33. Several respondents noted particular circumstances or cases (for example, rate-setting entities) that would require them to continue capitalizing G-PP&E land and permanent land rights. Others also noted the inability to separate the cost of land from an infrastructure or investment holding's overall cost. As a result, some of these respondents asked for an exception to the de-recognition requirement. The Board reviewed each of the cited instances. It notes that exceptions are not warranted because entities are free to include disclosures of the cost of G-PP&E land and permanent land rights at their discretion without explicit guidance to do so. Additionally, it would be confusing to have some entities reporting G-PP&E land and permanent land rights on the face of the financial statements while other entities exclude land and permanent land rights.

Additionally, if the reporting entity believes the cost of G-PP&E land and permanent land rights are critical to the users of financial statements, such information can be presented in the note disclosure. Concerning inseparable land costs, the Board believes that reasonable estimates can be made to identify infrastructure costs apart from land costs to ensure appropriate accounting and reporting. For example, estimates can be derived from (1) public land records such as property tax assessments or ownership documents, (2) comparable market analyses or appraisals, and (3) comparable or similarly recorded real property holdings or investments.

Balance Sheet References

A34. In providing the note disclosure information required for G-PP&E land and permanent land rights (at SFFAS 6, par. 45A) and SL (at SFFAS 29, par. 40), entities may combine the display and/or disclosure for G-PP&E land and permanent land rights and SL. However, the category distinctions should remain evident to the reader. That is, although the Board has established uniform disclosure requirements to increase informational value, the existing distinction between G-PP&E land and SL has been retained.

Disclosure requirements for the CFR (contained at SFFAS 32, par. 23 and SFFAS 29, par. 42) may also combine the display and/or disclosure for G-PP&E land and permanent land rights and SL and permanent land rights. In such cases and to the extent possible, direct references to agency reports for additional category information about G-PP&E land and permanent land rights and SL and permanent land rights should be made.

Supporting Documentation

A35. The Board has continually noted the concerns associated with providing corroborating documentation on historical assets including land. In the basis for conclusions to SFFAS 29 (par. 86-88), the Board briefly discussed the fundamental issues associated with historical assets and SL. In addition, Technical Release (TR) 9, *Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land,* addresses this difficulty by specifically noting the complexities regarding land. For example, federal land was acquired through (1) ceded territory by the original thirteen colonies, (2) territorial annexations, (3) purchases, and (4) treaties. Acquisitions and disposals of land were not documented like modern land transactions. TR 9 makes the point that records and detailed listings from these periods generally do not exist. As a result, the Board concluded that management's assertion concerning land ownership and its related estimates of acres of land and permanent land rights must be based on non-traditional supporting documentation and reasonable acre estimates, respectively. Consistent with the Board's views on SFFAS 29 and TR 9, for this standard, an entity may estimate acreage based on different underlying sources of data to include traditional and/or geospatial mapping, historical records, surveys, plats, etc., or any combination thereof. Additionally, given the diverse nature of how land has been acquired into the public domain, information from different vintages or time-periods would be expected to affect acreage estimation methods and/or techniques. Additionally, an entity is not expected to adjust its acreage estimates for insignificant amounts of: in-holdings,[19] intra-agency shared lands, or acquisitions or disposal of land. Entity estimates can be based on different underlying sources of data applying different measurement and/or mapping methods and can be deemed reasonable within industry accepted tolerance levels applied at an aggregation level (e.g., by national park or reserve, regional/district office, topography/land cover, etc.) as defined by

[19]In-holdings - An in-holding is privately owned land inside the boundary of a national park, national forest, state park, or similar publicly owned, protected area. Generally, in-holdings result from private ownership of lands prior to the designation of the protected park or forest area, which then end up grandfathered within the legally designated boundary.

management. That is, the level of aggregation and assignment of land and permanent land rights used to determine predominant use may be determined by the preparer considering the entity's mission, types of land use and how it manages the assets (e.g., by national park or reserve, bureau, regional/district office, topography/land cover, etc.). For example, the reporting entity may determine that predominant use is determined by national park or forest. Further, the entity may determine that the predominant use of a national park or forest is conservation and preservation even though some uses of the national park or forest are for operational or commercial use, but are not predominant uses. Appendix B provides illustrative examples of what sub-categories or activities could be included within each land use sub-category.

Some respondents raised the issue that land and permanent land rights may have multiple uses and it may be difficult to sub-categorize its predominant use into one of the three predominant use sub-categories. The Board considered whether there should be an additional use sub-category if preparers encountered challenges in sub-categorizing land and permanent land rights into one of the three sub-categories. The Board believes that providing the preparer and entity management with a predominant use definition and flexibility in determining the level of aggregation of land used to determine predominant use, would improve the ability of reporting entities to determine predominant use. Further, Appendix B provides an illustration of what sub-categories or activities could be included within each land use sub-category. Nevertheless, the Board also recognizes that these are new sub-categories and that unforeseen implementation issues may be encountered. Consequently, during the implementation phase (FY's 2022-2025) of this standard, the Board encourages reporting entities to communicate any challenges as well as suggestions in sub-categorizing land use reporting to the Land Implementation Task Force.

A36. The Board notes that it (1) does not seek exact precision in determining estimated acres or predominant use assessments and (2) does not intend to direct or prescribe the use of any particular approach.

A37. The Board concluded that it can facilitate effective reporting on land by (1) providing implementation guidance incorporating aspects of TR 9 and (2) reminding readers that, because most federal land was acquired in a variety of ways and over the nation's early settlement and formation, it is not unreasonable that supporting documentation will be developed using alternative methods and/or take on different forms of corroboration as foreseen by TR 9. For example, ownership can be evidenced by public law, treaties, entity certifications, maintenance or renovation contracts, historical maintenance records, a history of payment of invoices, minutes of meetings, historical databases, initial surveys of land, a history of past/historical practices (for example, the length of time an entity controls the land establishing de facto ownership), or other relevant sources of information. These alternatives may provide acceptable evidence of government ownership. Entities could use the above forms of supporting documentation to reasonably estimate acres or rely on management tools such as geospatial information. The Board expects preparers to apply a variety of documented methods and techniques in arriving at estimates.

Application of this Statement

A38. Reporting entities are subject to the reporting requirements under paragraph 13 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Specifically, paragraph 12 of SFFAS 21 states, "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Therefore, reporting entities with G-PP&E land deemed to be material should follow the guidance in SFFAS 21, paragraph 13.a-13.c. for all changes in accounting principles:

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.

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.

SFFAS 21 provides that 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. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and briefly describe the effect on beginning net position.

Implementation and Effective Date

A39. The Board proposed in the Exposure Draft issued on April 30, 2018, that the disclosure requirements would begin in fiscal year 2021 as RSI and transition to note disclosures with removal of G-PP&E land and permanent land rights from the balance sheet in fiscal year 2024.

The Board considered respondent comments to the exposure draft and interested party views, noting the time needed for reporting entities to:

(1) develop and implement related policies and procedures,

(2) establish estimates of acres and acres by predominant use sub-category as of the beginning of the first year of implementation,

(3) develop and maintain supporting documentation,

(4) develop and implement systems and processes for capturing and recording acreage information (balances and transactions during the year by predominant use sub-category), design and implement appropriate internal controls, and update such systems, processes, and controls as necessary for any updated guidance, and

(5) validate that the required information is independently verifiable or auditable.

Additionally, the Board considered the time needed for:

- "The Board to consider implementation issues (e.g. preparation and audit challenges, updated preparation and audit cost information), and through Board deliberations, determine how to best respond to those issues, and
- "Developing and issuing preparer and audit guidance relative to non-financial information.

The Board considered concerns from several respondents and members with respect to the uncertainty of costs associated with preparing and auditing the non-financial information, and the need to obtain better information on implementation challenges and costs.

The Board also considered the potential impacts of the COVID-19 pandemic on agencies' ability to implement this Statement.

In light of the considerations noted above, the Board recognized that additional implementation time was needed to present information in RSI and before transitioning the RSI requirements to the notes. Therefore, the Board extended the presentation in RSI to fiscal year 2022 and the transition of RSI requirements to the notes and the removal of G-PP&E land and permanent land rights from the balance sheet from fiscal year 2024, as proposed in the ED, to fiscal year 2026. The Board believes that the extension should allow adequate time to identify and address implementation challenges, including any cost-benefit considerations, while it is reported as RSI.

Given the potential implementation challenges related to this Statement, the Board agreed to include a separate project on its technical agenda to monitor implementation challenges, and to assess the need, as appropriate, for actions to address those challenges prior to transition of the RSI requirements to the notes. Consistent with Board principles and practice, such actions may include, among other things, staff guidance, AAPC guidance, interpretations, or additional standards, as determined appropriate based on Board deliberations. The Board intends to establish working groups, comprising stakeholders, including major landholding agencies and users to conduct these assessment and research activities.

In addition, the Board discussed the following proposed timetable, including actions to be taken by preparers and auditors and potential actions to be taken by the Board as well as other entities, as appropriate:

- "Fiscal Years 2022 and 2023: Presentation of total acreage and acreage by predominant use sub-categories as RSI, as well as identification of implementation issues and, as appropriate, Board actions to address them.
- "Fiscal Years 2022 and 2023: GAO plans to develop and issue audit guidance, in cooperation with the Council of the Inspectors General on Integrity and Efficiency (CIGIE), for auditing total acreage and acreage by predominant use sub-categories.
- "Fiscal Years 2023 and 2024: Presentation of total acreage and acreage by predominant use sub-categories as RSI, application of audit procedures to RSI and identification of preparation and audit challenges, and as appropriate, Board actions to address them.
- "Fiscal Year 2025: The Board plans to complete its assessment of remaining implementation issues associated with preparation and audit of the RSI (both total acreage and predominant use sub-categories), and, as appropriate, take actions to address them, before the RSI requirements transition to the notes.

Board Approval

A40. This Statement was approved with a vote of 7 members in favor of its issuance. Ms. Kearney and Mr. Bell dissented to the issuance of this statement. Their dissents are presented below. Written ballots are available for public inspection at FASAB's offices.

A41. Ms. Kearney dissents to the issuance of this Statement. She agrees with the goal of the Statement, which is to promote transparency into and accountability for the use of Government land. However, Ms. Kearney shares concerns expressed by major landholding agencies in response to the exposure draft and in subsequent discussions with the Board. Ms. Kearney's concerns are that this Statement does not include an option to classify land acreage as having multiple uses and that this Statement would require reporting and auditing that has not been demonstrated to be cost-beneficial.

Over two thirds of all of the Government's land[20] is required by law[21] to be managed under principles of multiple use. Requiring agencies to specify a single predominant use for multi-use land would put large land management agencies in the untenable position of having to identify and report a predominant use for land that is inconsistent with the use of the land as specified in statute.

At any particular time, land acreage may have multiple uses. It may be used simultaneously for ranching or logging (commercial), a wildlife habitat (preservation/conservation), and a staff office (operational). In addition, one or more of these uses can change over time, especially following catastrophic events, such as wildfires or hurricanes. Requiring agencies to assign a single predominant use to multi-use land would seem to frustrate rather than further the goals of transparency and accountability.

Ms. Kearney appreciates that the Board intends to monitor implementation of this Statement, including the ability to classify land according to a single predominant use. Ms. Kearney also appreciates that the Board intends to assess the need for further guidance to address any implementation challenges that may arise prior to transitioning the reporting from RSI to basic information. However, Ms. Kearney shares concerns expressed by major landholding agencies that the intended transition from RSI to basic reporting together with the challenges associated with assigning a single predominant use would create a burden on agencies that does not fully justify the cost of collecting, reporting, and auditing the information. Ms. Kearney shares these concerns particularly in light of: (1) the availability to the public of reliable Government land information (e.g., the Bureau of Land Management's Official Federal Land Records website and the U.S. Geological Survey's Protected Areas Database) and (2) the broad range of financial information that is currently reported as RSI under existing FASAB standards, including information about natural resources and deferred maintenance and repairs.

A42. Mr. Bell dissents to the issuance of this Statement. Mr. Bell commends FASAB for its thorough examination of the issue, which encompassed several years. In particular, Mr. Bell acknowledges and appreciates that the Board intends to include a separate project on its technical agenda to monitor implementation challenges, and to assess the need, as appropriate, for actions to address those challenges prior to transition of the RSI requirements to basic reporting as note disclosure.

[20]See, *Federal Land Ownership: Overview and Data, the Congressional Research Service*, February 21, 2020, which provides information about land acreage managed by the Department of Interior's Bureau of Land Management and the Department of Agriculture's Forest Service, https://crsreports.congress.gov/product/pdf/R/R42346.

[21]See, for example, the Federal Land Management and Policy Act of 1976 and the Multiple Use and Sustained Yield Act of 1960.

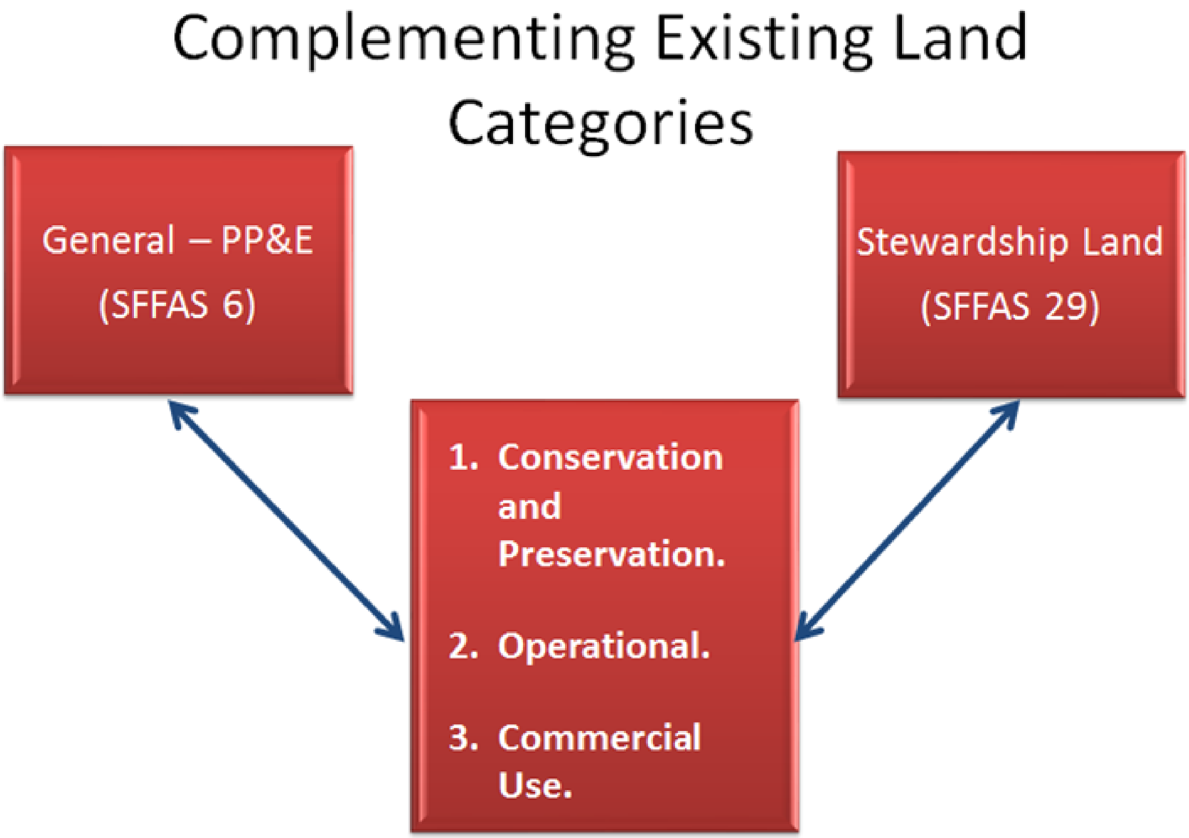
Mr. Bell supports enhanced transparency in financial reporting, whether such transparency takes the form of financial or non-financial information. However, Mr. Bell shares concerns expressed by some agencies in response to the exposure draft and in subsequent discussions with the Board that the disclosures required by this Statement could potentially create a burden that does not fully justify the cost required to collect, analyze, report, and audit the information needed to comply with this Statement. Of particular concern among these agencies is that this Statement does not include an option to classify land acreage for which a single predominant use cannot practically be: (1) determined or (2) distinguished from other, simultaneous predominant uses across multiple categories ("multi-use"). Certain agencies indicated that substantial acres of federally-owned land are or can be subject to multiple, concurrent uses for different purposes, on both perpetual and periodic bases. As such, in these cases, complying with this Statement's requirement to assign a single "predominant use" could be cost-prohibitive, precipitate undue preparation burden, and result in reporting that is not reasonably reflective of the land's actual use.

APPENDIX B: ILLUSTRATIONS

Sub-Categorizing Land - Predicated on Predominant Land-use

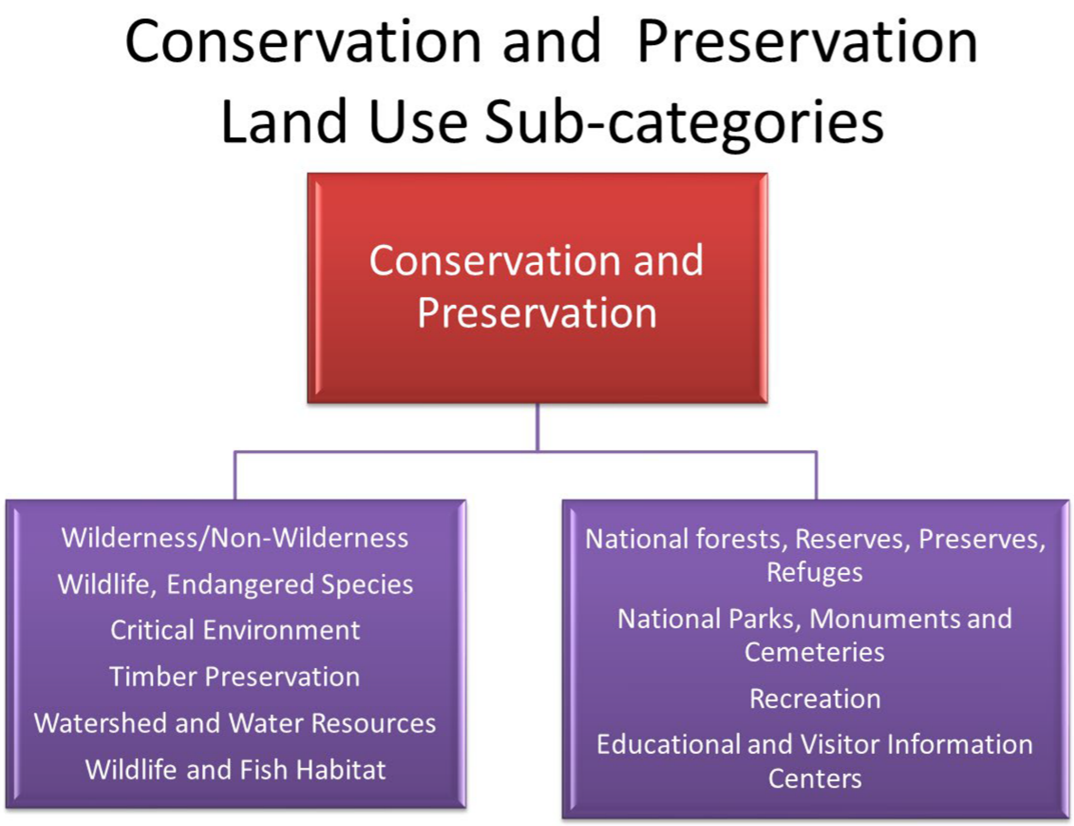
This appendix illustrates the application of certain key provisions of this Statement to assist in clarifying their meaning. The following partial sample illustrations at Appendices B-1 through B-2 are intended to aid in the application of these key provisions and not illustrate compliance with all of the disclosure requirements.

The Board has noted the potential need to have additional sub-categories predicated on predominant land-use to complement the land categories currently in use: SL and G-PP&E land. Illustrations demonstrating how the Board envisions the sub-categories complementing the existing requirements follow:Illustrations demonstrating how the Board envisions the sub-categories complementing the existing requirements follow:


Complementing Existing Land Categories
General – PP&E
(SFFAS 6)
Stewardship Land
(SFFAS 29)
1. Conservation and Preservation.
2. Operational.
3. Commercial Use.

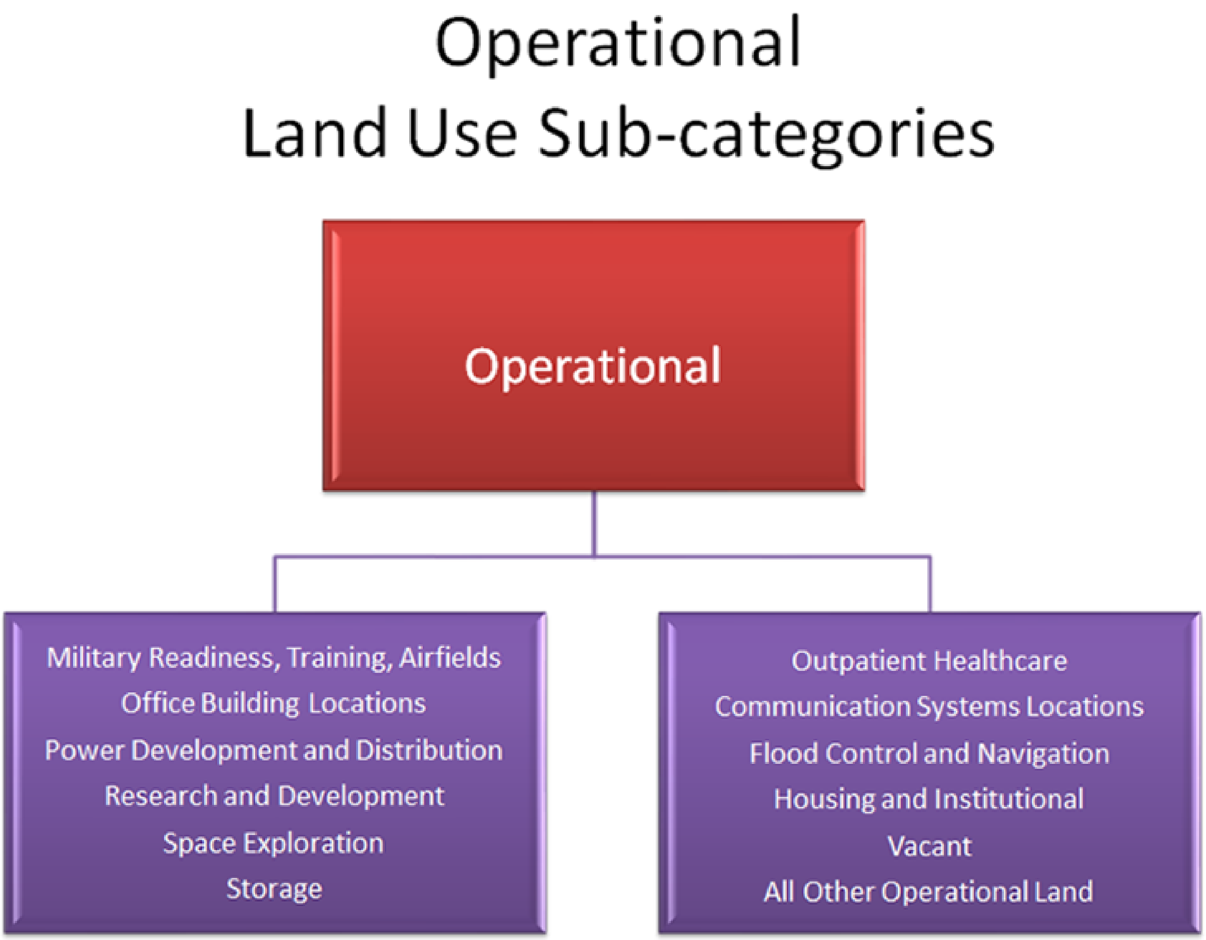
Conservation and Preservation Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the conservation and preservation land use sub-category.



Operational Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the operational land use sub-category.



Commercial Use Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the commercial use land use sub-category.

	Categorized by Purpose or Intent at Acquisition	Sub-categorized by Predominant Use				
Entity	**General PP&E Land Acres**	**Conservation and Preservation**	**Operational**	**Commercial Use**	**Total Land Acres**	**Explanatory Comments**
Agency X	6,563,954	2,600,000	3,963,954	0	6,563,954	1
Bureau A	2,219,324	0	2,219,324	0	2,219,324	2
Bureau B	863,343	0	863,343	0	863,343	2
G-PP&E Total - Department B	9,646,621	2,600,000	7,046,621	0	9,646,621	

Explanatory Comments

1 - **Agency X** has reclaimed 2,600,000 acres of its operational land for conservation/preservation purposes. Although some of the agency's operational land generates commercial revenue, it is incidental to the land's predominant use and its reporting does not change. All land is managed by 12 regional offices and the agency's land is considered to be active (in current use).

2 - **Bureaus A and B** maintain land strictly for operational purposes. Bureau A's land portfolio is managed by 2 district offices (DO's) and all land is considered to be active (in current use). Bureau B's land portfolio is managed by a single district office. Pursuant to statutory requirements, 7,200 acres of Bureau B's managed land located in the district's northwest corridor are held for disposal or exchange. All remaining land managed by Bureau B is considered to be inactive (not in current use) awaiting Congressional reviews.

Entity	Categorized by Purpose or Intent at Acquisition Stewardship Land Acres	Sub-categorized by Predominant Use Conservation and Preservation	Operational	Commercial Use	Total Land Acres	Explanatory Comments
Agency X	96,251,797	89,507,814	0	6,743,983	96,251,797	1
Bureau A	46,932,741	44,512,434	0	2,420,307	46,932,741	2
Bureau B	40,101,267	40,101,267	0	0	40,101,267	3
SL Total - Department B	183,285,805	174,121,515	0	9,164,290	183,285,805	

Explanatory Comments

1 - **Agency X** has reclaimed 2,600,000 acres of its operational land for conservation/preservation purposes (see Appendix B-1). Note that the reclaimed land retains its G-PP&E distinction and accordingly, is NOT added to the SL category illustrated above in this Appendix; that is, the land's predominant use is reflected within the G-PP&E category.

The agency been granted authority to generate revenue on additional SL currently sub-categorized as Conservation and Preservation land and as a result, has placed such land in a revenue-generating operating mode. However, because the land only generates an immaterial amount of revenue sporadically during the year, its predominant use is not re-categorized to Commercial Use. All land is managed by 12 regional offices and the agency's land is considered to be active (in current use).

2 - **Bureau A** has been granted authority to generate revenue on all of its SL and required to increase commercial uses where practical.
During the year additional SL has been placed in a revenue generating status and appropriately added to the existing Commercial Use sub-category balance.
All land is managed by 2 regional offices that oversee 100 different watershed projects (e.g., drainage basins and catchments).
Pursuant to statutory requirements, 10,200 acres of Conservation and Prerservation land located at 3 different sites are held for disposal or exchange.

3 - **Bureau B** maintains land strictly for conservation/preservation purposes. Any operational use of the land is incidental and is not considered to be a predominant use.
All land is managed by 2 regional offices that oversee 20 different energy projects (e.g., nuclear, solar, and water).

Entity	Stewardship Land Acres	General PP&E Land Acres	Total Land Acres	Conservation and Preservation	Operational	Commercial Use	Total Land Acres	Explanatory Comments
	Categorized by Purpose or Intent at Acquisition			Sub-categorized by Predominant Use				
Department A	234,889,617	12,362,611	247,252,228	223,145,136	12,362,611	11,744,481	247,252,228	1
Department B	183,285,805	9,646,621	192,932,426	176,721,515	7,046,621	9,164,290	192,932,426	2
Agency 1	84,626,746	4,454,039	89,080,785	84,626,746	4,454,039	0	89,080,785	3
Agency 2	75,666,349	3,982,439	79,648,788	37,833,174	3,982,440	37,833,174	79,648,788	4
Bureau 1	5,871,628	8,528,076	14,399,704	5,871,628	6,396,057	2,132,019	14,399,704	5
Total	584,340,145	38,973,786	623,313,931	528,198,199	34,241,768	60,873,964	623,313,931	

Explanatory Comments

1 - **Department A** has been granted authority to generate revenue on most of its SL. However, only 11.7 million acres is actively devoted to commercial use. SL which generat intermittent or insignificant revenues has been excluded because such land maintains its predominant use as conservation or preservation land. For related details please refer to Department A's annual financial report.

2 - **Department B** has also been granted authority to generate revenue on some of its SL but it has also reclaimed 2,600,000 acres of its operational land for conservation or preservation purposes. In addition, 17,400 acres (Bureau A 10,200 conservation and preservation acres and Bureau B 7,200 operational acres) of land are held for disposal or exchange pursuant to statutory requirements. For related details please refer to Department B's annual financial report.

3 - **Agency 1** has not been granted any commercial use authority and operates under a strict mandate to preserve land under its care. For related details please refer to Agency 1's annual financial report.

4 - **Agency 2** has been granted authority to generate revenue on all of its SL. However, only half or 37.8 million acres is actively devoted to commercial use at any point in tim during the reporting period. Although the remaining half is eligible for commercial use it remains in a conservation status because revenues generated are intermittent or insignificant and do not meet the predominant use requirement. For related details please refer to Agency 2's annual financial report.

5 - **Bureau 1** maintains buffer zones for national security purposes on land withdrawn from the public domain and also via acquisition from surrounding communities. It has been granted authority to lease, sell or otherwise dispose of operational land. One-quarter or 2.1 million acres of G-PP&E land is predominantly used for commercial purposes. For related details please refer to Bureau 1's annual financial report.

ILLUSTRATION: SFFAS 59, Accounting and Reporting Of Government Land Implementation Timeline

Effective Date: SFFAS 59, par. 15 - 16

The scope of this Statement (paragraphs 1-3) is effective for reporting periods beginning after September 30, 2021. The information required at paragraphs 6 and 7 (G-PP&E land), paragraphs 8-10 (stewardship land), paragraph 11 (government-wide stewardship land), and paragraph 12 (government-wide G-PP&E land) should be presented as RSI for fiscal years 2022 through 2025 and transition to note disclosures in fiscal year 2026. Asset dollar amounts for G-PP&E land and permanent land rights should remain on the balance sheet along with existing disclosures through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures and paragraphs 4, 5, 13, and 14 become effective. Existing display and disclosure (balance sheet reference) for stewardship land should *continue through fiscal year 2025 until they are superseded by the requirements at Paragraphs 8-10 beginning in fiscal year 2026.*

SFFAS 59 Par. #	Effective FY 2022 - 2025	Effective FY 2026
Par. 1 - 3: Scope	**YES** The Statement does not apply to: a. land held in trust or administered on behalf of Indian tribal governments or individual Indian land b. the Outer Continental Shelf (OCS)	**YES** The Statement does not apply to: a. land held in trust or administered on behalf of Indian tribal governments or individual Indian land b. the Outer Continental Shelf (OCS)
Par 4: Amendments To SFFAS 6, Accounting For Property, Plant, And Equipment	**NO** This paragraph amends SFFAS 6 to clarify that land and permanent land rights are to remain in the general property, plant, and equipment (G-PP&E) category but are not to be capitalized.	**YES** This paragraph amends SFFAS 6 to clarify that land and permanent land rights are to remain in the general property, plant, and equipment (G-PP&E) category but are not to be capitalized.
Par. 5: Amendments To SFFAS 6, *Accounting For Property, Plant, And Equipment*	**NO** This paragraph amends paragraph 40 by providing guidance for establishing opening balances consistent with the amended reporting requirements for G-PP&E land.	**YES** This paragraph amends paragraph 40 by providing guidance for establishing opening balances consistent with the amended reporting requirements for G-PP&E land

SFFAS 59 Par. #	Effective FY 2022 - 2025	Effective FY 2026
Par. 6: This paragraph amends SFFAS 6 disclosure requirements.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 7: This paragraph amends SFFAS 6 by inserting additional definitions.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 8: This paragraph amends SFFAS 29 to clarify the definition of SL and references to general PP&E.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 9: This SFFAS 29 paragraph is amended to require estimated acres of land and the sub-categorization of land use.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 10: This paragraph amends SFFAS 29 by inserting additional definitions.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized

SFFAS 59 Par. #	Effective FY 2022 - 2025	Effective FY 2026
Par. 11: This paragraph amends paragraph 42 of SFFAS 29, addressing the U.S. government-wide financial statement disclosures.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 12: This paragraph amends SFFAS 32 to revise the government-wide disclosure requirements for property, plant, and equipment.	**YES** Information is presented as RSI	**YES** Information converts to Basic (Note Disclosure) and G-PP&E Land is derecognized
Par. 13: Amendments to SFFAS 7, *Accounting For Revenue And Other Financing Sources And Concepts For Reconciling Budgetary And Financial Accounting.*	**NO** This paragraph amends SFFAS 7 to clarify guidance regarding transfers and donations of land.	**YES** This paragraph amends SFFAS 7 to clarify guidance regarding transfers and donations of land.
Par. 14: Amendments To SFFAS 42, *Deferred Maintenance And Repairs.*	**NO** SFFAS 42 is amended to ensure that deferred maintenance and repair (DM&R) information is reported in non-capitalized G-PP&E land.	**YES** SFFAS 42 is amended to ensure that deferred maintenance and repair (DM&R) information is reported in non-capitalized G-PP&E land.

Appendix C: Abbreviations

CFR	Consolidated Financial Report of the U.S. Government
DM&R	Deferred Maintenance and Repairs
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
G-PP&E	General Property, Plant, and Equipment
GIS	Geographic Information System
M&R	Maintenance and Repairs
NFI	Non-financial Information
OCS	Outer Continental Shelf
PP&E	Property, Plant, and Equipment
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SL	Stewardship Land
TR	Technical Release

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 (Rescinded)

Status

Issued	March 12, 1997
Effective Date	For fiscal periods beginning after September 30, 1997
Affects	None.
Affected by	SFFAS 31 rescinded Interpretation 1 in its entirety.

SFFAS 31, *Accounting for Fiduciary Activities* par. 36 rescinded Interpretation 1.

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
Affects	None.
Affected by	• SFFAS 12 affects Interpretation 2 paragraphs 3 and 8
Related Guidance	TR No. 1, *Audit Legal Representation Letter Guidance*

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.

Table Of Contents

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 loss[1]. 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.

[1]See paragraph 39 in SFFAS #5 for the complete discussion on "Estimating Contingent Liabilities."

[2]See 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 claim[3], regardless of the fact that the payment may be paid in full or in part by the Judgment Fund. The contingencies[4] 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 4[6], 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.

[3]In most cases this determination involves the U.S. Department of Justice.

[4]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 or loss.

[5]See paragraphs 35 - 42 in SFFAS # 5 for the complete discussion on “Contingencies.”

[6]See 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 entries[7] 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.

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.

[7]Actual journal entries are under the authority of the Standard General Ledger.

Interpretation of Federal Financial Accounting Standards 3: Measurement Date for Pension and Retirement Health Care Liabilities (Rescinded)

Status

Issued	August 29, 1997
Effective Date	For fiscal periods beginning on or after September 30, 1997
Affects	None.
Affected by	SFFAS 33 rescinded Interpretation 3 in its entirety.

SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates* rescinded Interpretation 3.

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
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.

Table Of Contents

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"] cost[1] 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 FERS, 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 <u>more than</u> 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 entity's FERS pension expense may be <u>less than</u> 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

[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.

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.

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.

[2] This 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.

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,

 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

[3] The amounts used for CSRS are from the example in SFFAS No. 5, paragraph No. 78.

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 *(FERS $570,000 + CSRS $100,000)*	670,000	
CR. Funds with Treasury *(FERS $570,000 + CSRS $60,000)*		630,000
CR. Imputed Financing (CSRS)		40,000

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	
CR. Pension Expense		35,000

(2) to off-set the transfer-out against imputed financing:

DR. Imputed Financing	35,000	
CR. Transfer-out		35,000

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 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 *(FERS $580,000 + CSRS $100,000)*	680,000	
CR. Imputed Financing *(CSRS)*		40,000
CR. Funds with Treasury *(FERS $580,000 + CSRS $60,000)*		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 *(FERS $580,000 - $535,000 = $45,000)*	45,000	
CR. Pension Expense		45,000

(2) to off-set the transfer-out against imputed financing:

DR. Imputed Financing (CSRS)	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]

[4]SFFAS No. 5, para. 74.

[5]See Statements of Federal Financial Accounting Concepts and Standards, Original Statements, "Appendix E: Consolidated Glossary" on page 1, 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.

[6]For 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, *Accounting for Revenue and Other Financing Sources of the Federal Government and Concepts for Reconciling Budgetary and Financial Accounting*
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 taxes collected on their behalf to recognize a portion of IRS's net taxes receivable.

Table Of Contents

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.

[1]Certification 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 of Federal Financial Accounting Standards 6: Accounting for Imputed Intra-departmental Costs: *An Interpretation of SFFAS No. 4* (Rescinded)

Status

Issued	April 18, 2003
Effective Date	for periods beginning after September 30, 2004
Affects	SFFAS 4, *Managerial Cost Accounting Standards and Concepts*
Affected by	• SFFAS 30, Inter-Entity Cost Implementation. SFFAS 30 rescinds par. 110 of SFFAS 4 • SFFAS 55 rescinded Interpretation 6 in its entirety,

SFFAS 55, *Amending Inter-entity Cost Provisions* rescinded Interpretation 6 in its entirety.

Interpretation of Federal Financial Accounting Standards 7: Items Held for Remanufacture

Status

Issued	March 16, 2007
Effective Date	Effective upon issuance.
Affects	SFFAS 3
Affected by	None.

Table of Contents

Introduction

Purpose

1. Current standards do not provide specific guidance to assist preparers and auditors in the classification, valuation and reporting of items that are in the process of major overhaul or remanufacture for sale or for internal use. This Interpretation identifies acceptable options for classification, valuation and reporting by applying existing standards, in particular Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*.

Scope

2. This Interpretation applies to reparable parts and subassemblies that are in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. This Interpretation addresses remanufacturing activity for items intended for sale or for internal use. Items held for remanufacture may consist of direct materials (including repairable parts and subassemblies, also referred to as “carcasses” at the Department of Defense (DoD)), and work-in-process where products are restored to serviceable condition and/or improved/upgraded condition for sale or internal use.

3. Long-lasting spare parts were not specifically addressed in SFFAS 3. It is not the intent of this Interpretation to imply that long-term spare parts for issuance without reimbursement should or should not be classified as Operating Materials and Supplies.

Exclusion

4. This Interpretation does not apply to stand-alone items such as entire airplanes, ships, tanks, intercontinental ballistic missiles (ICBMs) or other higher assemblies that function independently.

Materiality

5. The provisions of this Interpretation need not be applied to immaterial items.

Effective Date

6. This Interpretation is effective upon issuance.

Interpretation

Definitions

7. Items "**held for remanufacture**"[1] are in the process of (or awaiting) inspection,[2] disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of:

   - Direct materials, (including repairable parts or subassemblies, also referred to as "carcasses" at the DoD) and
   - Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to "good-as-new" condition and/or improved/upgraded condition.

8. "Items held for remanufacture" share characteristics with "items held for repair" and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent and cost-effective manner to classify processes as "repair" or "remanufacture."

9. Items held for remanufacture may be intended for sale (placed in **inventory** held for sale upon completion of remanufacture) or for internal use (issued to a user within the same reporting entity upon completion of remanufacture).

[1]Terms appearing for the first time in **bold** are defined in the Glossary, Appendix D of this document.

[2]The process of inspection may include holding an item until an inspection can be done.

Recognition and Measurement

Items Intended for Sale (Inventory)

10. Inventory items intended for sale that are held for remanufacture may be valued in accordance with either paragraphs 20-22 or paragraphs 32-33 of SFFAS 3.[3] For example, paragraph 21 states that "Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location." Applied to reparable parts and subassemblies returned for credit in the purchase of a serviceable item, historical cost would be the credit, if any, issued to the customer who returned the item to be repaired and any identifiable and chargeable transportation and handling costs. Regardless of the method used, reparable items returned by customers should be initially valued at less than the value of new or fully remanufactured items with similar features and useful lives. As the inspection and remanufacture process takes place, appropriate "production costs" would include normal costs to bring the item to serviceable or upgraded condition.

11. "Abnormal costs" to be excluded would include any costs that are in excess of the cost to purchase and place in service a new item with similar features and useful life. For items that are no longer available on the open market, or which are being upgraded, management should use judgment in determining normal and reasonable costs to be capitalized.

12. Inventory items held for remanufacture share characteristics with inventory held for repair and items in production for sale (direct materials and work-in process) and may be aggregated with either class of items for reporting purposes.

Items Not Intended for Sale (Operating Materials and Supplies)

13. Items held for remanufacture that meet the definition of **Operating Materials and Supplies**, if significant, may be recognized as a category of operating materials and supplies and valued in accordance with paragraphs 32-33 or paragraphs 42-44 of SFFAS 3.

14. Items held for remanufacture that meet the definition of Operating Materials and Supplies should be initially valued at less than the value of new or fully remanufactured items. As the inspection and remanufacture process takes place, appropriate "production costs" would

[3] The paragraphs of SFFAS 3 that are cited in this document are displayed in Appendix C.

include normal costs to bring the item to serviceable or upgraded condition. Abnormal costs to be excluded would include any costs in excess of the cost to obtain and place in service a new item with similar features and useful life. The allowance or direct methods may also reasonably be applied to operating materials and supplies.

Disclosure Requirements

Component Entity Report Disclosures

15. The disclosures for inventory items held for remanufacture should conform with paragraph 35 of SFFAS 3.

16. The disclosures for items held for remanufacture that meet the definition of Operating Materials and Supplies should be in accordance with the requirements of paragraph 50 of SFFAS 3. If significant, Operating Materials and Supplies held for remanufacture may be disclosed as a separate category.

Financial Report of the U.S. Government Disclosures

17. For the Financial Report of the U.S. Government, there is no provision for valuation or recognition that is different from requirements for the component level.

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by members in reaching the conclusions in this Interpretation. It includes reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Project History

A1. Accounting for the federal government's physical assets that are held as inventory or as operating materials and supplies is complex and has been addressed in numerous FASAB Standards.[4] The Board continues to address issues as they arise. In March of 2006, the Department of Defense (DoD) Deputy Chief Financial Officer sent a letter to the Board (see Appendix D) requesting specific guidance for items held for remanufacture.

A2. The DoD requested that SFFAS 3 be amended to provide standards for inventory held for remanufacture. The DoD noted that the category of inventory "held for repair" is not defined in the standards, and that the valuation methods for "held for repair" in paragraphs 32-33 of SFFAS 3 are not cost effective to apply to items held for remanufacture within the moving average cost method, since the moving average cost of a serviceable item changes continually.

Outreach Activities

A3. FASAB published the ED on August 1, 2006. 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,* the CFO Council, the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past. During the comment period, FASAB staff also contacted agencies that were likely to have remanufacturing activity to ensure that they were aware of the ED's scope and comment period. FASAB staff also met with representatives of agencies with significant remanufacture activities.

[4] Inventory: see SFFAS 3; Property Plant & Equipment: see SFFAS 6, amended by SFFAS 10, 14, 16 and 23.

A4. Six written comments were received from the following sources:

Source of comments	Federal (Internal)	Non-Federal (External)
Users, academics, others		1
Auditors	1	
Preparers and financial managers	4	

A5. Among the issues identified by respondents were: items meeting the definition of Property, Plant and Equipment; inconsistent use of numerous acceptable methodologies within an agency; and the difficulty of distinguishing between routine maintenance and minor repair versus remanufacture.

Property, Plant and Equipment

A6. Paragraph 12 of the Exposure Draft stated that “Parts and subassemblies held for remanufacture that are intended for use, rather than sale, and which meet the definition of Property, Plant and Equipment, should be recognized as a category in Property, Plant and Equipment and should be valued in accordance with SFFAS 6, as amended.”

A7. More than one respondent objected to this paragraph, stating that it implied that such items should be classified and depreciated as Property, Plant and Equipment and that it would be costly to change the accounting for such items. The respondents noted that the request for guidance focused on (a) the issue that existing FASAB standards do not recognize the existence of Operating Materials and Supplies held for repair or remanufacture, and (b) existing standards imply that only the direct or allowance methods, and not historical cost, are acceptable valuation methods. Accordingly, the scope of the Interpretation has been reduced to address only Inventory and Operating Materials and Supplies that are in the process of repair or remanufacture.

Inconsistent Practice within Agencies

A8. One respondent noted that there are inconsistent accounting practices within an agency, and that the proposed Interpretation, which points out numerous acceptable options, might exacerbate this problem.

A9. Selecting among acceptable valuation methods and establishing uniformity throughout a reporting entity is a management responsibility. The purpose of the Interpretation is to point out acceptable methods, rather than to make selections on behalf of agencies.

Definition and Exclusions

A10. This Interpretation is limited to reparable parts and subassemblies, which are not specifically addressed in current standards, and for which guidance has been requested by the DoD. This Interpretation does not apply to stand-alone items that function independently; such as entire airplanes, ships, tanks, ICBMs and other stand-alone items. Such items are already addressed in SFFAS 3 and SFFAS 6, as amended.

“Repair” versus “Remanufacture”

A11. There is no “bright line” that distinguishes items held for remanufacture from items held for repair. A clear example of a repair might be a minor or routine servicing that is performed in the field (or “on the shelf” for an item that is for sale). A clear example of remanufacture might be an item that is sent to a central depot for a total overhaul, or for an upgrade that results in the item being assigned a new National Stock Number to indicate the change in the nature of the item. For processes that involve more than the “repair” example above, but less than the “remanufacture” examples, management should use judgment to determine a reasonable, consistent and cost-effective manner to classify processes as “repair” or “remanufacture.”

Inventory Valuation

A12. SFFAS 3 provides basic principles of inventory valuation applicable to both inventory in the process of production for sale and held for repair:

- Historical cost valuation is to be applied to inventory (SFFAS 3, paragraphs 20, 32, 33 and 42),
- Historical cost includes all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location, (SFFAS 3, paragraphs 21 and 43) and
- Abnormal costs should be expensed when incurred (SFFAS 3, paragraphs 21 and 43).

A13. Given the common objectives described above for the two categories and the absence of clear distinctions between the two categories, the Board does not believe that an amendment is needed. The Board believes that in some circumstances the only thing that distinguishes the remanufacturing process from the production process is that the raw materials include items previously in service.

A14. The Board believes that the intent of paragraphs 17-34 of SFFAS 3 is that an item held for remanufacture should be initially valued at less than the value of a new or serviceable item, and that as the work on the item progresses, the value of the item should be increased accordingly. The Board believes that any of the three methods (the allowance method or the direct method, described in paragraphs 32-33 of SFFAS 3 or the historical production cost method described in paragraphs 21 and 43 of SFFAS 3) would provide results that would meet this objective.

Operating Materials and Supplies Held for Repair or Remanufacture

A15. SFFAS 3 did not anticipate the existence of a significant category of Operating Materials and Supplies held for repair or remanufacture. For example, reparable parts and subassemblies related to tactical munitions may meet the definition of Operating Materials and Supplies. The Board believes that any of the three valuation methods described for inventory in paragraphs A12-A14 above may be reasonably applied to operating materials and supplies.

Effective Date

A16. Interpretations do not have an effective date, as they carry the effective dates of the standard(s) being interpreted.

Board Approval

A17. This interpretation was approved for issuance by all members of the Board.

Appendix B: Glossary

[See consolidated Glossary in Appendix E of this document.]

Appendix C: Relevant Citations of Current Standards

SFFAS 3, *Accounting for Inventory and Related Property*

[20] ***Valuation.*** Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost.

[21] (1)Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

[22] The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost system).

[32] ***Inventory Held for Repair.*** Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.

> (1) Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established. The annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.

[33] (2) Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

[35] ***Disclosure Requirements.***

- General composition of inventory.
- Basis for determining inventory values; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods; if any.

- Balances for each of the following categories of inventory: inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements.
- Restrictions on the sale of material.
- The decision criteria for identifying the category to which inventory is assigned.
- Changes in the criteria for identifying the category to which inventory is assigned.

Operating Materials and Supplies

[36] ***Definition.*** "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

[37] Operating materials and supplies shall be categorized as (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies. These categories are defined in paragraphs 36, 45, and 47 respectively.

[38] ***Recognition.*** The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and supplies shall be recognized and reported as assets when produced or purchased. "Purchased" is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

[39] The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.

[40] If (1) operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

[41] An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that

maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user.

[42] ***Valuation Under the Consumption Method.*** Operating materials and supplies shall be valued on the basis of historical cost.

[43] Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

[44] The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).

[50] ***Disclosure Requirements.***

- General composition of operating materials and supplies.
- Basis for determining operating materials and supplies values; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods; if any.
- Balances for each of the categories of operating materials and supplies described above.
- Restrictions on the use of material.
- The decision criteria for identifying the category to which operating materials and supplies are assigned.
- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

Appendix D: Letter from Department of Defense Deputy Chief Financial Officer

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

MAR 16 2006

Ms. Wendolyn Comes
Executive Director
Federal Accounting Standards Advisory Board 441 G. Street, N.W.
Washington, DC 20548

Dear Ms. Comes:

The Department of Defense (DoD) is continuing to take steps to implement its financial management improvement plans and accounting processes. In the course of this process, we have taken a critical look at the Department's business process for the repair of inventories, and the applicability of the Statement of Federal Financial Accounting Standard (SFFAS) No. 3 as it relates to inventory repair. In line with this review, we have also researched comparable commercial processes through available web-based literature as well as through direct contact with commercial firms. Subsequent to consideration of all our findings, we have concluded that the Department's repair process is directly comparable to the private sector process typically referred to as "remanufacturing," and that our reparable carcasses (referred to as "cores" in the private sector) acquired in exchange sales for reparable items are similar, if not the same, as "raw materials" or components used in the remanufacturing process. More importantly, we have come to believe that "inventory repair" suggests a misleading process when viewed in the context of rebuilding worn and used carcasses/cores for the primary purpose of providing rebuilt items for new sales. The following paragraphs elaborate on our findings and conclusions.

Based on commercial sourced information noted above, we found that the remanufacturing process had specific characteristics that were virtually parallel regardless of product or entity (i.e., commercial or DoD). Both remanufacturing companies and the DoD acquire worn carcasses/cores through exchange sales of remanufactured items or newly procured items with financial incentives or credit given for the exchanged cores. Both inspect, disassemble, evaluate, clean, rebuild, refurbish, and restore products to "good-as-new" condition for inclusion as finished goods inventory and for sale to new customers. More importantly, both often enhance products with upgrades which incorporate new technologies, reduce obsolescence, extend useful life, increase safety, and improve reliability.

Regardless of the technical processes, or the definition attached to the process, we believe that certain, fundamental attributes must be considered in the accounting solution when inventory items are repaired:

- First, inventory, by definition, is "held for sale." Since inventory held for sale is typically found on "warehouse shelves," the repair of damaged items in current storage, and the return of those items to the warehouse is a rare or immaterial event.
- Second, since it is rare for on-the-shelve, held-for-sale items to be repaired, we can generally conclude that any large-scale inventory item repair process, whether undertaken by commercial firms or the DoD, will always be a "source-of-supply" process which provides rebuilt or remanufactured items for new sales.
- Third, it can also be concluded that rebuild processes for resale will always involve some form of market-based or incentive-based business process which provide for the return of worn or used carcasses/cores for rebuild. Carcasses/cores then become similar to raw material and, more importantly, should reflect the cost to obtain them.
- Finally, regardless of the name attached to the refurbishment process, i.e., "repair," "rebuild," "remanufacture," or other, a fundamental rule of accounting states that "all costs incurred to place assets into use, or to get inventory items ready for sale, should be capitalized into the cost of the asset."

Despite these attributes, paragraphs 32 and 33 (Inventory Held for Repair) of SFFAS No. 3 provide that entities should charge or credit the difference between actual and estimated repair costs to current period expense. However, when the process its correctly viewed as a process undertaken with the intent of rebuilding returned worn and used cores for subsequent resale, we believe that limiting the application of capitalized repair to estimated repair is not only inappropriate but, in fact, distorts the matching of cost of sales and revenue at time of sale.

Reconciliation of the historical cost requirements in Statement No. 3 with the requirements set forth in paragraphs 32 and 33 are problematic. The SFFAS No. 3 provides that entities value Inventory Held for Sale at historical cost. Paragraph 21 defines historical cost to “include all appropriate purchase, transportation and production costs incurred to bring items to their current condition and location." Inaddition, commercial accounting principles for inventory cost have always been guided by a fundamental rule of capitalization as stated in Accounting Research Bulletin 43, Chapter 4, Paragraph 5, as follows: “The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset.” When applied to inventories, cost means, in principle, the "sum of all applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location." Paragraphs 32 and 33 of Statement 3, however, impose restrictions on both cost capitalization and the value of carcasses. Paragraphs 32 and 33 require that regardless of the level of effort or cost incurred to rebuild items for resale, rebuild costs must be expensed as period costs if they exceed estimated repair. Secondly, paragraphs 32 and 33 dictate that carcass costs are not independent, but rather are a. function of the cost of related serviceable items less estimated repair. This principle ties the value of carcasses to the procurement cost of serviceable items and thus, subjects carcasses to a continuing revaluation unrelated to their cost.

Each year, the Department, through incentive exchange sales from our revolving funds or through directed returns, processes thousands of reparable item returns (i.e., carcasses) for subsequent repair/rebuild. Similarly, thousands of commercial firms obtain cores through exchange sales or through available market purchases for remanufacturing. The objectives of this business process in both instances are to: (1) establish an alternative source of supply that utilizes the main component of the items being rebuilt, and (2) repair/rebuild/remanufacture the carcasses or cores for subsequent resale. From an accounting perspective, we have to believe that commercial firms can only be capitalizing such costs into the cost of the products sold in lieu of period repair expense. It appears clear that reporting repair expenses for large-scale remanufacturing and resale operations would be in conflict with accepted accounting principles, would understate their inventory and cost of goods sold, and would mismatch costs and revenue at the time of sale. Based on these conclusions, and those attributes we summarized previously, the following and remaining paragraphs state our proposals for SFFAS No. 3 inventory repair principles.

We propose that Inventory Held for Repair be revisited in terms of the prevailing business process. As stated in our first and second attributes above, we believe that "inventory repair" per se is a rare event that, if viewed in terms of overall principles, will reveal source-of-supply and resale objectives.

We propose that "repair expense" be subjected to a critical and theoretical review in terms of "inventory repair." Textbook examples of repair expense versus repair capitalization typically make reference to real property and fixed assets. Capitalized repair is matched to revenue through depreciation charges. Since inventory is not depreciated, capitalized repair can, therefore, only match revenue as a part of cost of goods sold. We believe this is the correct answer; however, there is little, if any, accounting guidance in this area.

If it is concluded that large-scale inventory repair is undertaken primarily for the purpose of selling rebuilt/remanufactured items, we then propose that the question of cost capitalization be subjected to the general requirement to capitalize all costs to bring inventory items to the point of sale. We believe this issue should also be subjected to the question of "asset value or life added" versus the objective of "resale." That is, it can be argued that if repair does not add substantial value or life to an inventory item, then it should be expensed. We believe that the sale objective and the matching of cost of goods sold should be the prevailing factor.

If it is concluded that inventory repair is a rebuild/resell process, we then propose that the valuation of carcasses/cores be independent of the cost of items held for sale. We believe that carcasses should be valued at "cost."

These proposals, depending on your consideration or conclusions, could bring to bear additional changes or findings. For example, recording carcasses at cost a and rebuilt items at full cost could negate the need for the allowance method or direct method and potentially revise the implementation adjustments currently stated in Paragraph 34 (i.e., reporting entities which accrued amounts for repair expense under previous standards based on estimated repair costs may be required to make subsequent adjustments for carcasses held at cost without an allowance). Paragraph 17(3) could be revised to include remanufactured components. In addition, it should be kept in mind that this letter addresses only inventory for sale (or repaired for ultimate resale). There are variations of repair and spare parts management in some industries (airlines for example) that repair or rebuild items for internal recycling only. These items, we believe, are accounted for as depreciable assets.

My staff will be pleased to work with you or anyone you deem to be appropriate on the FASAB staff on this issue and will provide any assistance or information that you determine to be necessary. Questions or requirements for additional information can be directed to my point of contact, Mr. Wayne Hudson. Mr. Hudson can be reached by phone at (703) 697-8281 or by e-mail at wayne.hudson@osd.mil.

Sincerely,

Teresa McKay
Deputy Chief Financial Officer

Interpretation of Federal Financial Accounting Standards 8: An Interpretation of Statement of Federal Financial Accounting Standards 56, Classified Activities

Status

Issued	March 15, 2019
Effective Date	Effective upon issuance.
Affects	SFFAS 56
Affected by	None.

Summary

The objective of SFFAS 56 is to balance the need for financial reports to be publicly available with the need to prevent the disclosure of classified national security information or activities in publicly issued General Purpose Federal Financial Reports (GPFFRs). SFFAS 56 allows financial presentation and disclosure to accommodate user needs in a manner that does not impede national security.

SFFAS 56 permits modifications that do not affect net results of operations or net position. In addition, SFFAS 56 allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.

Further, Interpretations of SFFAS 56, which may themselves contain classified information, will address the requirements of this and other standards and permit other modifications when needed to prevent the disclosure of classified information. Modifications permitted by SFFAS 56 and future Interpretations may affect the net results of operations and/or net position of those entities applying the Interpretations.

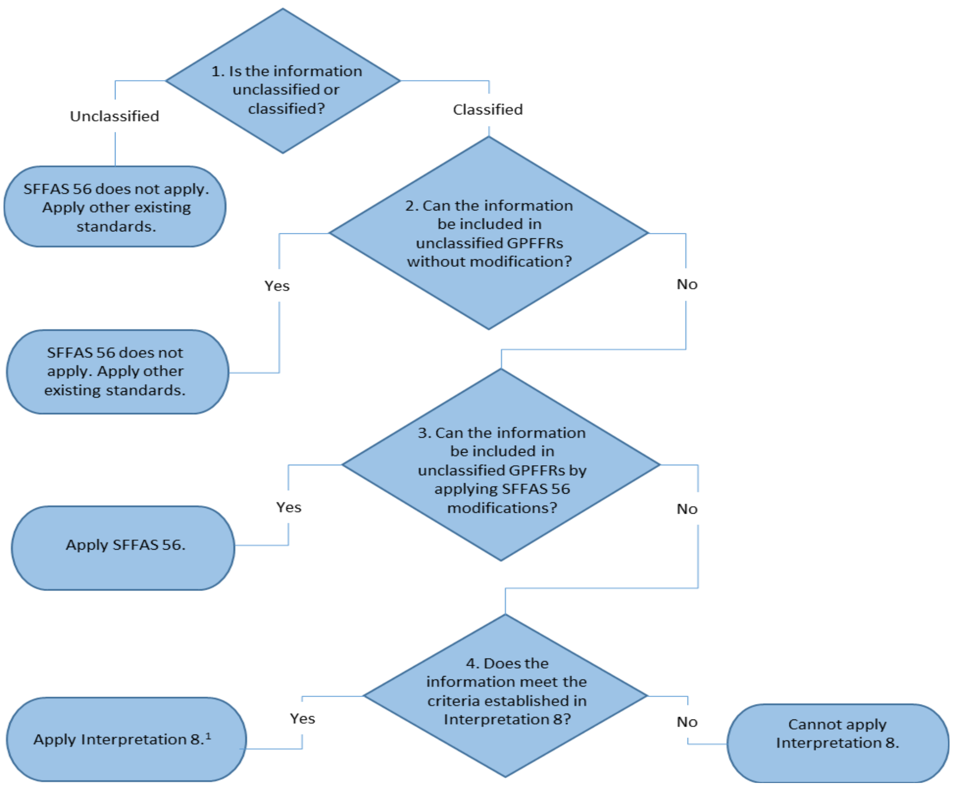
Interpretation 8 is the first classified interpretation of SFFAS 56 that allows modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position.

Interpretation 8 provides a decision chart (see below) illustrating the Board's intended implementation of the Interpretation. The Interpretation does not relieve reporting entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment as it relates to non-public records and reports.

Interpretation 8 will be maintained by FASAB. Due to the classified nature of Interpretation 8, contact FASAB to arrange access to Interpretation 8 as needed. FASAB will provide access to the Interpretation following appropriate security procedures.

Application Decision Chart

Below is a decision chart illustrating the Board's intended implementation of SFFAS 56 and classified Interpretation 8. This guidance does not relieve reporting entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment as it relates to non-public records and reports. This illustration is non authoritative and depicts the process described in the guidance.



[1] The guidance may be applied at the program or transaction level.

Interpretation of Federal Financial Accounting Standards 9, Cleanup Cost Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5 & SFFAS 6

Status

Issued	August 16, 2019
Effective Date	For periods beginning after September 30, 2019. Early implementation is permitted.
Affects	This Interpretation clarifies SFFAS 5 and SFFAS 6 regarding cleanup costs liabilities.
Affected by	None.

Summary

With the issuance of *Statement of Federal Financial Accounting Standards (*SFFAS) 47*, Reporting Entity,* SFFAS 55, *Amending Inter-entity Cost Provisions, and* Technical Bulletin 2017-2*, Assigning Assets to Component Reporting Entities,* there is a need for additional guidance to assist in the application of cleanup cost liability standards at the component reporting entity level.

This Interpretation provides clarification and guidance regarding cleanup cost liabilities when the component reporting entity responsible for reporting on an asset during its useful life is different from the component reporting entity that will eventually be responsible for settling the liability for the cleanup cost of that asset.

This Interpretation facilitates reporting by component reporting entities by better aligning reporting with their operations.

Materiality

The provisions of this Interpretation 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

Table of Contents

Interpretation

Scope

1. This Interpretation applies when a component reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

INTERPRETATION

General Principles for Component Reporting Entities

2. SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 19 states, "A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events."

3. Paragraphs 56-57 of SFFAS 47, *Reporting Entity,* provide that component reporting entities' GPFFRs must include all consolidation and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity consolidates the component reporting entity GPFFRs and includes information regarding disclosure entities.

   56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity[footnote omitted] and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

   57. A component reporting entity's GPFFR should include all organizations that would allow the users to hold the component reporting entity's management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby

enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities[footnote omitted] and disclosure entities administratively assigned to it.

4. SFFAS 47, paragraph 10 defines component reporting entity as follows:

Component Reporting Entity-"Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.[7] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

FN 7 The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

5. In light of SFFAS 5 and SFFAS 47, the following general principles apply for component reporting entities:

   a. liabilities generally should be reported by the component reporting entity for which the future outflow or sacrifice of resources is probable and measurable.

   b. Liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

Guidance on Cleanup Costs

6. SFFAS 6, *Accounting for Property, Plant, and Equipment,* chapter 4: Cleanup Costs[1] provides the definition of cleanup costs and provides that cleanup costs meet the definition and criteria for recognition of liabilities included in SFFAS 5. SFFAS 6, paragraph 91 explains that liabilities should be recognized when three conditions are met:

   a. A past transaction or event has occurred.

   b. A future outflow or other sacrifice of resources is probable.

   c. The future outflow or sacrifice of resources is measurable.

[1]Cleanup costs are 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. (*FASAB Handbook, Appendix E: Consolidated Glossary*)

7. SFFAS 6 supplements SFFAS 5[2] by providing additional guidance regarding cleanup costs. SFFAS 6 associates the recognition of cleanup costs with the life of the related general property, plant, and equipment (PP&E). Paragraph 94 provides for the estimation of cleanup costs when the associated general PP&E is placed in service. Paragraph 97 provides for the recognition of a portion of the estimated total cleanup costs as an expense during each period that the general PP&E is in operation.

8. SFFAS 6 is based on the assumption that the cleanup cost and the associated general PP&E would be recognized by the same component reporting entity. However, this assumption may be contrary to actual practice.

9. Some component reporting entities settle liabilities by transferring general PP&E to another component reporting entity designated by law, rule, or administrative regulation to fund the liabilities.[3] In such cases,[4] a component reporting entity that recognizes general PP&E during its useful life may differ from the component reporting entity that will eventually be responsible for the future outflows or other sacrifices of resources required for cleanup costs or funding the cleanup liability. Instead, the component reporting entity receiving the asset upon its removal from service[5] will be responsible for funding the cleanup cost.

10. When multiple component reporting entities have distinct responsibilities regarding general PP&E and related cleanup costs, information needed to monitor and update cleanup cost liabilities would typically be more readily available to the component reporting entity that reports the general PP&E. Such component reporting entities settle the cleanup cost liability by transferring the general PP&E for cleanup. Until the component reporting entity recognizing the general PP&E transfers the general PP&E, it should continue to recognize the liability. Upon transferring the general PP&E, it should also transfer the associated liability.

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[2]SFFAS 5 applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or when cleanup is an ongoing part of operations.

[3]Component reporting entities designated by law, rule, or administrative regulation to fund liabilities are distinguishable from those component reporting entities that may receive excess property and are not responsible for settling the liability.

[4]This Interpretation provides guidance when the cleanup costs and the associated liability are designated to a different component reporting entity than the component reporting entity reporting the general PP&E.

[5]Technical Release (TR) 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, provides guidance on the disposal, retirement, or removal from service of general PP&E as well as related cleanup costs. It differentiates between permanent and other than permanent removal from service of general PP&E and delineates events that trigger discontinuation of depreciation and removal of general PP&E from accounting records.

11. The SFFAS 5 liability recognition criterion that "a future outflow or other sacrifice of resources is probable" should be considered met by the component reporting entity that recognizes the general PP&E during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup. At that time, the general PP&E and the liability should be de-recognized by the component reporting entity that recognized them during the general PP&E's useful life and recognized by the component reporting entity that will liquidate the liability. De-recognition and recognition of the general PP&E and liability should be performed in accordance with existing standards.

Effective Date

12. The requirements of this Interpretation are effective for reporting periods beginning after September 30, 2019. Early implementation is permitted.

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

Appendix A: Basis For Conclusions

This appendix discusses some factors considered significant by Board members 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. The standards enunciated in this Interpretation-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

Background

A1. The Department of Defense (DoD) asked the Federal Accounting Standards Advisory Board (FASAB or "the Board") for guidance regarding accounting for liabilities at the component reporting entity level. Specifically, clarifications were requested about the recognition and measurement standards related to contingent liabilities and cleanup costs. FASAB provides the recognition and measurement standards in SFFAS 5 and SFFAS 6.

A2. With the issuance of recent pronouncements SFFAS 47, SFFAS 55, *Amending Inter-entity Cost Provisions,* and Technical Bulletin (TB) 2017-2, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of the general liability standards and principles. This is especially needed when multiple component reporting entities are involved.

A3. For example, with the issuance of SFFAS 55, SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*, and Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, are rescinded; therefore, the requirement to impute costs for these activities is eliminated. Further, the Board's intent with TB 2017-2 is to provide flexibility with respect to asset assignment. SFFAS 47 recognizes the complex organizational structure of the federal government and provides a basis for determining which organizations should be included in the reporting entity's GPFFRs. It also provides definitions for reporting entity, component reporting entities, and sub-component reporting entities within the federal government.

A4. Entities requested clarification with respect to the accounting for contingent liabilities when one or more sub-component reporting entities within a single component reporting entity are designated to manage litigation and pay any resulting liabilities on behalf of one or more other sub-component reporting entities.

A5. Entities also requested guidance regarding cleanup cost liabilities when the component reporting entity responsible for reporting the general PP&E during its useful life is different from the component reporting entity that will eventually be responsible to fund cleanup costs upon disposal of that general PP&E.

A6. These types of examples and the issuances of the new pronouncements warrant consideration of the need for guidance about how the general liability standards and principles should be applied. Without additional guidance, these situations may lead to inconsistent application of the liability standards and principles.

General Principles for Component Reporting Entities

A7. Paragraphs 56-57 of SFFAS 47 provide that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity consolidates the component reporting entity GPFFRs and includes information regarding disclosure entities. SFFAS 47 also provides the definition for component reporting entity.

A8. In light of SFFAS 5 and SFFAS 47, this Interpretation provides general principles that apply for component reporting entities.

Guidance on Cleanup Costs

A9. SFFAS 6 provides guidance for recognizing liabilities for cleanup costs, and SFFAS 5 provides guidance for recognizing liabilities from government-related events such as cleanup of environmental damage. FASAB has provided guidance in this area through several technical releases (TRs), but additional guidance is necessary in light of recent pronouncements.

A10. Challenging issues exist in the application of general standards for large, complex departments, such as DoD, that have numerous components and sub-components. For example, assets may be owned by one component reporting entity but used or funded by another component reporting entity, and the component reporting entity using the asset may not be the component reporting entity responsible for funding cleanup costs. Given the complex responsibilities and relationships among the components of large departments, the second condition of paragraph 91 in SFFAS 6 results in inconsistent application of the standards. The condition requires that "a future outflow or other sacrifice of resources is probable."

A11. Additionally, SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required[6] with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget. Further, TB 2017-2 provides flexibility so that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. These new pronouncements provide additional flexibility when considered in conjunction with SFFAS 5 and SFFAS 6.

A12. SFFAS 6 outlines the requirements for the disposal, retirement, or removal from service of general PP&E. Paragraphs 97-98 of SFFAS 6 outline the requirements for recognition and measurement of disposal-related cleanup costs. TR 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, addresses implementation guidance that further clarifies existing SFFAS 6 requirements for the disposal, retirement, or removal from service of general PP&E as well as related cleanup costs. The guidance helps differentiate between permanent and other than permanent removal from service of PP&E assets. The guidance recognizes the many complexities involved in the disposal of PP&E and delineates events that trigger discontinuation of depreciation and removal of PP&E from financial reporting.

A13. Some general PP&E requiring cleanup is transferred to another component reporting entity after being removed from service. An example would be a military service responsible for reporting the general PP&E that will eventually be transferred to the Defense Logistics Agency for cleanup. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources to settle the liability for cleanup costs. Instead, the component reporting entity receiving the general PP&E for the cleanup has or assumes that responsibility because it was designated by law, rule, or administrative regulation to fund the liability. This does not include component reporting entities that receive excess property and are not responsible for settling the liability.

A14. For the purpose of meeting the liability definition of cleanup costs at the component reporting entity level (when multiple sub-component reporting entities have distinct responsibilities for general PP&E and for settling the related liability), the condition to determine whether "a future outflow or other sacrifice of resources is probable" can be

[6]SFFAS 55 provides for the continued recognition of significant inter-entity costs by business-type activities. Non business-type activities may elect to recognize other imputed costs.

considered met as long as the liability is reported with the general PP&E until the general PP&E is removed, contained, or disposed of. At that time, the liability would be transferred with the related general PP&E to the component reporting entity responsible for the liability. The entity transferring the general PP&E should ensure supporting documentation for the estimated cleanup costs is provided to the receiving entity.

A15. A general illustration for the entries[7] to recognize the liability for the cleanup cost and subsequent transfer by the component reporting entity using the general PP&E follows.

As provided in SFFAS 6, the component reporting entity using the general PP&E would recognize the cleanup cost and accrue the liability over time as the asset is used.

DR. Expense
    CR. Liability

Upon cleanup, the component reporting entity transfers the liability and related general PP&E to the component reporting entity responsible for liquidating the liability.

DR. Liability
    DR. Other Financing Source - Transfer Out
    CR. General PP&E

A16. A general illustration for the entry to recognize the general PP&E and the liability by the component reporting entity that will liquidate the liability follows.

DR. General PP&E
    CR. Other Financing Source -Transfer In
    CR. Liability

Disclosures

A17. Although the Interpretation may result in changes in reporting of cleanup costs when multiple component reporting entities are involved, existing GAAP provides sufficient guidance to ensure proper disclosures regarding these changes in reporting. SFFAS 55 requires component reporting entities to disclose that only certain inter-entity costs are recognized for goods and services received from other federal entities at no cost or at a cost less than the full cost. Component reporting entities should identify the costs of the providing

[7]The journal entries are presented for an understanding of the Interpretation and do not address specific general PP&E transactions or resulting ending balances. In addition, actual journal entries are under the authority of the Standard General Ledger.

entity that are not fully reimbursed and the general nature of other imputed costs recognized in their financial statements. Statement of Federal Financial Accounting Concepts 3, *Management's Discussion and Analysis,* and SFFAS 15, *Management's Discussions and Analysis,* also provide guidance on information to include in the management's discussion and analysis if deemed appropriate.

A18. Given the sufficiency of current disclosure standards and guidance, the Board concluded it is not necessary to address disclosure in this Interpretation. Agencies should consider current standards in deciding whether to disclose the nature of changes in reporting resulting from this Interpretation.

Other

A19. Because FASAB provided the guidance regarding the application of cleanup cost standards through other pronouncements, such as TBs and TRs, additional documents may require updating to ensure conformance and consistency with current GAAP. Therefore, FASAB will make necessary updates to the appropriate documents. Those updates are considered exclusive of the cleanup cost liability issue presented within this Interpretation. Further, those changes or updates must be made in separate GAAP documents to ensure the appropriate level of guidance within the GAAP hierarchy results. Specifically, this pronouncement is an Interpretation; TBs and TRs can only be amended through other TBs and TRs.

Summary of Outreach Efforts and Responses

A20. FASAB issued the exposure draft (ED), *Guidance on Recognizing Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5* on October 17, 2018, with comments requested by January 17, 2019.

A21. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News, the Journal of Accountancy,* the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A22. In addition, to encourage responses, a reminder notice was provided to FASAB's subscription email list on January 8, 2019. However, in light of the partial government shutdown during the comment period, some departments and agencies may not have been able to respond by the deadline; therefore, FASAB extended the comment deadline to March 11, 2019.

A23. FASAB received 15 comment letters from preparers, auditors, professional associations, financial managers, and users of federal financial information. The Board considered responses to the ED at its April 2019 meeting. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

No Need for Contingent Liability Guidance

A24. As noted in the background section, there had been a request for clarification and guidance regarding reporting contingent liabilities when multiple component reporting entities are involved. Therefore, the ED had proposed clarification for contingent liabilities when one or more sub-component reporting entities within a single component reporting entity are designated to manage litigation and/or pay any resulting liabilities on behalf of one or more other sub-component reporting entities.

A25. However, the majority of respondents disagreed with the proposal that the sub-component reporting entity responsible for managing litigation would have the information needed to recognize contingent liabilities and should therefore report information in accordance with SFFAS 5. Instead, the majority of the respondents believed that the sub-component reporting entity whose actions gave rise to the litigation should report the information in accordance with SFFAS 5.

A26. Respondents that disagreed with the proposal regarding contingent liabilities provided substantial comments and several different reasons for their disagreement. There was not a universal or common theme from the respondents, and responses were fairly general.

A27. In addition to the general disagreement with the proposal, certain respondents noted concern about the effect on reporting for responsibility segments within their consolidated financial statements. The proposal was not intended to affect disaggregated information within a single audited financial statement for a component reporting entity with multiple responsibility segments. However, some stated the same principles would or should apply to assigning costs to responsibility segments. From the comments, it appeared that the proposed contingent liability guidance may not have provided the intended guidance but rather led to greater ambiguity and questions in implementation.

A28. After further consultation with the agency that requested guidance in this area, the agency determined that the effect of receiving contingent liability guidance would be immaterial or minimal. In addition, neither the agency nor any other agency could provide other contingent liability examples that should be considered by the Board.

A29. Based on the comments and discussions with agency representatives, the Board determined that there was no need for guidance in the contingent liability area.

Clarification of Cleanup Guidance

A30. The majority of respondents agreed that the SFFAS 5 liability recognition criterion that "a future outflow or other sacrifice of resources is probable," should be considered met by the component reporting entity that recognizes the general PP&E during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity designated by law, rule or administrative regulation to fund the cleanup liability.

A31. One agency respondent disagreed with the proposal because it did not agree that the component reporting entity receiving the asset for cleanup should be responsible for settling the cleanup cost liability. The agency believed it could be interpreted that an agency receiving excess property had assumed responsibility for the environmental liabilities when it accepts the report of excess property, even when it is not responsible for settling the liability. This was not the Board's intent in issuing the Interpretation.

A32. The Interpretation provides guidance in the specific case when the entity receiving the general PP&E is responsible for settling the liability. As explained in paragraph 10, it provides the following context for the guidance: "Some component reporting entities settle liabilities by transferring general PP&E to another component reporting entity..."

A33. The Board determined additional clarification may be required to ensure it is clear that the Interpretation is not addressing cases when the entity transferring the general PP&E is still responsible for the liability. The Interpretation provides guidance when the cleanup costs and the associated liability are designated to a different component reporting entity than the component reporting entity reporting the general PP&E. Therefore, the Board added additional language and footnotes to the Interpretation to clarify this point.

A34. The Board recognizes that, in some cases, the Interpretation may cause a change in reporting of cleanup cost liabilities. However, the Board concluded the Interpretation will provide consistent application of SFFASs and resolve concerns that the community raised.

A35. Certain respondents provided additional suggestions and editorial comments related to this area. The Board carefully considered respondents' comments and several were adopted.

Other Liability Issues

A36. The Board recognizes the potential complexities in reporting and recognizing information in accordance with SFFAS 5 when multiple component reporting entities are involved. The Board requested feedback on the possibility of other similar liability situations or scenarios for consideration and whether an additional general liability principle should be included to address multiple component reporting entities. Respondents did not identify additional examples. Therefore, the Board concluded it is not necessary to provide a general principle.

A37. Although the scope of this Interpretation is only related to cleanup costs, the Board recognizes the potential for other liability issues involving multiple component reporting entities to arise in the future. The Board will consider other specific situations as they arise.

Board Approval

A38. This Interpretation was approved for issuance by all members of the Board.

Appendix B: Abbreviations

DoD	Department of Defense
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Report
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

Interpretation of Federal Financial Accounting Standards 10, Clarification of Non-federal Non-entity FBWT Classification (SFFAS 1, Paragraph 31): An Interpretation of SFFAS 1 and SFFAS 31

Status

Issued	May 10, 2021
Effective Date	Effective upon issuance.
Affects	This Interpretation clarifies SFFAS 1, paragraph 31.
Affected by	None.

Summary

This Interpretation clarifies the classification and presentation of non-federal non-entity Fund Balance with Treasury (FBWT) in paragraph 31 of Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*. This guidance provides that amounts received in deposit funds from non-federal sources in anticipation of an order (that is, an advance) should be classified as intragovernmental on component reporting entity financial statements.

SFFAS 1, paragraph 31 was amended by SFFAS 31, *Accounting for Fiduciary Activities*, to clarify the definition and reporting for fiduciary amounts on deposit in the U.S. Treasury and to distinguish fiduciary FBWT from federal component reporting entities' FBWT. While making this distinction, the amendment added the phrase "other non-federal non-entity FBWT." This Interpretation clarifies the classification by explaining that the inclusion of "other non-federal non-entity FBWT" in paragraph 31 of SFFAS 1 was intended to provide for similar treatment of activities comparable to fiduciary activities that SFFAS 31 had not identified specifically. This Interpretation clarifies that the Federal Accounting Standards Advisory Board did not intend to require similar treatment for activities that were explicitly excluded from the provisions of SFFAS 31.

Although amounts received in deposit accounts may come from non-federal non-entity sources for unfilled orders, these amounts do not qualify as fiduciary activity because SFFAS 31 specifically excludes unearned revenue from fiduciary activity reporting. Therefore, it would be inconsistent to apply the phrase "other non-federal non-entity" to unearned revenue, including amounts received from non-federal sources for unfilled orders.

Hence, non-federal non-entity amounts received for unfilled orders that are reflected in FBWT should be reported as an intragovernmental asset of the component reporting entity.

Materiality

The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial.[1] A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[1]Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.

Table of Contents

INTERPRETATION

Scope

1. This Interpretation applies when a component reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

Interpretation

2. SFFAS 1, Accounting for Selected Assets and Liabilities, paragraph 31 provides:

   A federal entity's fund balance with the Treasury (FBWT) 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. FBWT is an intragovernmental item, except for fiduciary or other non-federal non-entity FBWT. From the reporting entity's perspective, the reporting entity's FBWT is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.

3. SFFAS 1, paragraph 31 was amended by SFFAS 31, *Accounting for Fiduciary Activities*, to clarify the definition and reporting for fiduciary amounts on deposit in the U.S. Treasury and to distinguish fiduciary FBWT from federal component reporting entities' FBWT. While making this distinction, the amendment added the phrase "other non-federal non-entity FBWT." The Federal Accounting Standards Advisory Board (FASAB or "the Board") acknowledges that the amendments did not define the phrase "other non-federal non-entity FBWT" within SFFAS 31, and the added phrase may have led to a lack of clarity regarding classification and presentation of non-federal non-entity FBWT.

4. SFFAS 31 amended paragraph 31 of SFFAS 1 as follows (amendments are shown in bold and underscored):

A federal entity's fund balance with the Treasury **(FBWT)** 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. **FBWT** is an intragovernmental item, **except for fiduciary or other non-federal non-entity FBWT**. From the reporting entity's perspective, **the reporting entity's FBWT** is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. **In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.**

5. SFFAS 1, paragraph 31 provides that "FBWT is an intragovernmental item, except for fiduciary or other non-federal non-entity FBWT." The standards do not define the phrase "other non-federal non-entity FBWT." This Interpretation clarifies that the inclusion of "other non-federal non-entity FBWT" in paragraph 31 of SFFAS 1 was to provide for similar treatment of activities comparable to fiduciary activities that SFFAS 31 had not identified specifically. The Board did not intend to require similar treatment for activities explicitly excluded from the provisions of SFFAS 31.

6. Federal reporting entities often receive amounts in advance from customers-both federal and non-federal-for unfilled orders including amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process. Once received, the funds are deposited into the General Fund of the U.S. Government. Although amounts received in deposit accounts may come from non-federal non-entity sources for unfilled orders, these amounts do not qualify as fiduciary activity because SFFAS 31 specifically **excludes** unearned revenue from fiduciary activity reporting (see par. 13 of SFFAS 31). It would be inconsistent to apply the phrase "other non-federal non-entity" to amounts received in deposit accounts from non-federal sources for unfilled orders.

7. Hence, non-federal non-entity amounts received for unfilled orders (including amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process) and deposited into the General Fund of the U.S. Government should be reported as an intragovernmental asset by the component reporting entity.

Effective Date

8. The requirements of this Interpretation are effective upon issuance.

The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled Materiality, for a detailed discussion of the materiality concepts.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members 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. The standards enunciated in this Interpretation-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

Background

A1. Stakeholders (more than one federal reporting entity) requested FASAB to review paragraph 31 of SFFAS 1 and clarify the classification and presentation of FBWT. The request relates to how amounts received in deposit funds from non-federal non-entity sources in anticipation of an order (that is, an advance) should be classified and presented on the financial statements. The non-federal non-entity funds are deposited into the General Fund of the U.S. Government.

A2. There were questions regarding the presentation of the asset on the balance sheet. While the stakeholders and others agreed that it is a non-entity asset, there were differing views regarding whether it should be classified and presented as an intragovernmental asset (FBWT) or a non-federal asset (governmental) on the balance sheet. As discussed under the section GAAP Guidance, the questions regarding classification came up after the issuance of SFFAS 31 and the resulting amendments to SFFAS 1.

A3. The primary rationale for treating these advance payments as intragovernmental assets is based on the notion that these deposited amounts are owed by the General Fund of the U.S. Government (FBWT) to the entity responsible for the execution of the underlying agreement or transaction. As discussed in the subsequent sections, the proper classification of this line item is important to ensure there is no double counting of amounts at the government-wide level.

Prevalent Practice

A4. Most reporting entities (even those that did not request guidance on the issue) report the deposit funds as intragovernmental FBWT on the balance sheet and disclose the portion that is non-entity in the notes to the financial statements. This is consistent with requirements to show non-entity assets separately. Paragraph 26 of SFFAS 1 provides, "Non-entity assets recognized on an entity's balance sheet should be segregated from entity assets. An amount equal to non-entity assets should be recognized as a liability (due to Treasury or other entities) recognized on the balance sheet." Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, directs that the distinction be disclosed in the notes, not on the face of the Balance Sheet.

A5. The Department of the Treasury's Bureau of the Fiscal Service (Fiscal Service) is responsible for prescribing the accounting posting logic for the agencies through the Treasury Financial Manual. Fiscal Service is also responsible for ensuring proper application of intragovernmental eliminations at the government-wide financial reporting level.

A6. Fiscal Service representatives agreed that non-federal non-entity funds deposited into the General Fund of the U.S. Government should be reported as an intragovernmental asset because agencies are not holding the funds. The funds are being held by the General Fund of the U.S. Government. The General Fund is now a standalone reporting entity in the government. As more fully discussed in the next paragraph, with the General Fund's reporting, the accounting model was made complete for the federal government.

A7. Simply put, a component reporting entity's FBWT is eliminated with the General Fund's liability for FBWT. As a result, the amount received is reported in the General Fund's financial statements as an asset for the government via the consolidation of the Department of Treasury's financial statements to the government-wide financial statements. It is reported as Cash and Other Monetary Assets. Alternatively, if a reporting entity reported these amounts on a non-federal line on the balance sheet, the asset would be double counted on the government-wide financial statements.

A8. If the activity was fiduciary in nature, the General Fund identifies the fiduciary deposit funds and records a liability, ensuring that it is not eliminated and is, therefore, reported on the government-wide financial statements.

GAAP Guidance

A9. As noted previously, SFFAS 1, paragraph 31 provides:

A federal entity's fund balance with the Treasury (FBWT) 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. FBWT is an intragovernmental item, except for fiduciary or other non-federal non-entity FBWT. From the reporting entity's perspective, the reporting entity's FBWT is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.

A10. As noted, the issue relates to how amounts received in deposit funds from non-federal sources in anticipation of an order should be classified and presented on the financial statements. The non-federal non-entity funds are deposited into the General Fund of the U.S. Government.

A11. The Board acknowledges that the lack of clarity in SFFAS 1 is due to the amendments resulting from SFFAS 31. In addition, the standards do not define the phrase "other non-federal non-entity FBWT" and the added phrase led to ambiguity regarding classification and presentation of non-federal non-entity FBWT.

A12. SFFAS 31 amended paragraph 31 of SFFAS 1 as follows (amendments are shown in bold and underscored): A federal entity's fund balance with the Treasury **(FBWT)** 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. **FBWT** is an intragovernmental item, **except for fiduciary or other non-federal non-entity FBWT**. From the reporting entity's perspective, t**he reporting entity's FBWT** is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. **In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.**

A13. Regarding the intragovernmental classification, the differing views relate to the phrase "or other non-federal non-entity FBWT." The inclusion of "other non-federal non-entity FBWT" in paragraph 31 of SFFAS 1 was to provide for similar treatment of activities comparable to fiduciary activities that SFFAS 31 had not identified specifically. As evident in providing for specific exclusions in SFFAS 31, the Board did not want similar treatment for activities that were explicitly excluded from the provisions of SFFAS 31.

A14. SFFAS 31 provides for certain exclusions from the reporting requirements for fiduciary activities. For example, amounts related to unpaid payroll withholdings and garnishments are excluded from fiduciary reporting. In addition, unearned revenue should not be reported as fiduciary activity.

A15. While the amounts received in deposit accounts (by reporting entities that submitted the request for guidance) are from a non-federal fund source and deposited for unfilled orders, these amounts do not qualify as fiduciary activity because SFFAS 31 specifically excludes unearned revenue from fiduciary activity reporting (par. 13 of SFFAS 31). In this case, it would be inconsistent to apply the phrase "other non-federal non-entity deposit funds" to this activity. As noted, paragraph 13 of SFFAS 31 provides for this exclusion and specifically states:

Unearned revenue should not be reported as fiduciary activity and should be recognized as a liability in accordance with existing standards.8 Assets collected or received by a Federal entity that represent prepayments or advance payments for which the Federal component entity is expected to provide goods or services should not be classified as fiduciary activity. This exclusion applies broadly and applies to amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process, even if these amounts are not specifically classified as "unearned revenue" by the entity due to uncertainty about the ultimate realization of the revenue.

FN8 See SFFAS 1, paragraph 85 and SFFAS 7, Accounting for Revenue and Other Financing Sources, paragraph 37.

A16. Paragraph 49, in the basis for conclusions of SFFAS 31, addresses the specific topic of advances: Similarly, Federal component entities may hold advances received from customers for future sales of goods or services. Such advances represent unearned revenue. One Federal agency, in its written response and oral testimony, noted that certain advances received appear to meet the definition of fiduciary activity. However, this standard excludes unearned revenue from the fiduciary reporting requirements because unearned revenue is a routine operational activity and the Board believes that fiduciary reporting of unearned revenue is not warranted.

A17. The Board acknowledges that the amended wording may have led to the ambiguity that currently exists. However, this Interpretation clarifies that the underlying goals as intended are consistent regarding FBWT. Specifically, one should consider how FBWT is viewed from the component reporting entity and government-wide perspective in considering how these relationships are intertwined. In this relationship, FBWT is an intragovernmental asset for the component reporting entity because it represents the entity's claim to the federal government's resources. From the perspective of the federal government as a whole, it is not an asset in that intragovernmental amounts are eliminated in consolidation, and thus, would not appear on the government-wide balance sheet.

Clarification of Non-federal Non-entity FBWT Classification and Presentation

A18. The Board acknowledges that the lack of clarity in SFFAS 1 is due to the amendments resulting from SFFAS 31. The standards do not define the phrase "other non-federal non-entity FBWT" and the added phrase led to ambiguity regarding classification and presentation of non-federal non-entity FBWT. The Board concluded this Interpretation is the best vehicle to clarify the classification.

A19. SFFAS 1, paragraph 31 describes a federal entity's FBWT as the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. The paragraph also states, "FBWT is an intragovernmental item, except for fiduciary or other non-federal non-entity FBWT."

A20. This Interpretation clarifies that the inclusion of "other non-federal non-entity FBWT" in paragraph 31 of SFFAS 1 was intended to provide for similar treatment of activities that were comparable with fiduciary activity but that had not been identified specifically in SFFAS 31. This Interpretation clarifies that it was not intended to require similar treatment for activities that were explicitly excluded from the provisions of SFFAS 31.

A21. Federal reporting entities often receive amounts in advance from customers-both federal and non-federal-for unfilled orders including amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process. Although amounts received in deposit accounts may come from non-federal non-entity sources for unfilled orders, these amounts do not qualify as fiduciary activity because SFFAS 31 specifically **excludes** unearned revenue from fiduciary activity reporting (see par. 13 of SFFAS 31). Therefore, it would be inconsistent to apply the phrase "other non-federal non-entity" to this activity or amounts received in deposit accounts from non-federal sources for unfilled orders.

A22. Therefore, non-federal non-entity amounts for unfilled customer orders deposited into the General Fund of the U.S. Government should be reported as an intragovernmental asset by the component reporting entity.

A23. FBWT is an intragovernmental aggregate account between federal agencies and the General Fund of the U.S. Government. It is where funds are recorded until needed to fulfil the non-entity orders. This presentation is also consistent with guidance provided by OMB Circular A-136, *Financial Reporting Requirements*.

Summary of Outreach Efforts and Responses

A24. FASAB issued the exposure draft (ED), *Clarification of Non-federal Non-entity FBWT Classification (SFFAS 1, Paragraph 31): An Interpretation of SFFAS 1 and SFFAS 31*, on October 29, 2020, with comments requested by January 6, 2021.

A25. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, FASAB newsletter, the *Journal of Accountancy, the Chief Financial Officers Council*, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A26. To encourage responses, a reminder notice was provided to FASAB's subscription email list.

A27. FASAB received 16 comment letters from preparers, auditors, professional associations, and users of federal financial information. The Board considered responses to the ED at its February 2021 meeting. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A28. Respondents generally agreed with the Interpretation. Specifically, respondents generally agreed the Interpretation clarified that non-federal non-entity amounts received for unfilled orders that are reflected in FBWT should be reported as an intragovernmental asset of the component reporting entity. Certain respondents provided minor editorial clarifications that were carefully considered and adopted.

A29. Although the respondents were in agreement with the proposal, two respondents suggested defining other non-federal non-entity FBWT and one respondent suggested providing examples. The Board considered this beyond the scope of the Interpretation.

Board Approval

A30. This Interpretation was approved for issuance by all members of the Board.

Appendix B: Abbreviations

FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards

Technical Bulletin 2000-1: Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance

Status

Issued	June 2000
Effective Date	June 2000
Affects	None.
Affected by	None.

Table Of Contents

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.

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.

[1] Determination 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.

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
Affects	None.
Affected by	None.
Related Guidance	Interpretation 2, *Accounting for Treasury Judgment Fund Transactions*

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.

Table of Contents

Introduction

3.[A] 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;

[A]The pronouncement begins with par. 3 because par. 1 and 2 were the Executive Summary in the Exposure Draft.

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

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 ?

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

[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.

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 liability[2], 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 Technical 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] financial statements. Staff and the Board believe TJF 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 TJF 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 principal 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

[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.

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
Affects	Paragraph 79(g) of SFFAS 7 *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
Affected by	None.

Table of Contents

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 provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

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
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 value[1] 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.

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.*

Table of Contents

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 functions[2], personnel, assets, and liabilities resulting from the Homeland Security Act of 2002 (HS Act[3]). 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.

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 entity[6] transferred to receiving entities? (See Appendix C, page 17, 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 a gain or loss on disposal (see par. 12

[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.

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 17), 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 17). 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
Transferred Operations:		
Cost of Transferred Operations	$ XX	
Exchange Revenue from Transferred Operations	XX	
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.

13. SFFAS 7, par. 74, provides that transfers between entities without reimbursement should be recognized as "transfers-in[9] or out" on the Statement of Changes in Net Position. The amount transferred is equivalent to the book value[10] 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]

Accounting by Transferred Entities

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 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?

[9] It 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.

[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. 11."

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]

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 Technical Bulletin need not be applied to immaterial items.

[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.

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 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.

[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.

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 17) as well as criteria for determining if the activity of the component has been discontinued (FAS 144, par. 42, see page 17).

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

[15] “Discontinued operations” may be appropriate in the event that material functions are discontinued.

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.

Respondents' Request for Guidance on General PP&E Transfers

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"?

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.

Respondents' Request for Guidance on the Statements of Custodial Activity and Changes in Net Position

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.

Statement of Budgetary Resources

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)

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

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

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

[24]This 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]

[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).

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

    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.

Technical Bulletin 2006-1: Recognition and Measurement of Asbestos-Related Cleanup Costs

Status

Issued	September 28, 2006
Effective Date	For fiscal periods beginning after September 30, 2012
Affects	None.
Affected by	Technical Bulletin 2009-1, par. 2 and Technical Bulletin 2011-2, par. 2, amended the effective date in par. 50.

Summary

I. This technical bulletin clarifies the required reporting of liabilities and related expenses arising from asbestos-related cleanup costs. 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 standards and interpretations issued by FASAB.

II. Prior to this technical bulletin, most federal entities had recognized liabilities for the removal of asbestos that posed an immediate health threat (i.e., friable asbestos), but many federal entities had not prepared an estimate of cleanup costs for the future removal of asbestos that did not pose an immediate health threat (i.e., nonfriable asbestos). Therefore, it was determined that additional guidance was needed to clarify that entities need to estimate all asbestos-related cleanup costs and not just those costs related to asbestos that requires immediate cleanup.

III. The primary effects of this technical bulletin are that:

a. Federal entities will (1) estimate both friable and nonfriable asbestos-related cleanup costs and (2) recognize a liability and related expense for those costs that are both probable and reasonably estimable, consistent with the current guidance in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant, and Equipment*, Chapter 4: Cleanup Costs; and Technical Release (TR) 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

b. Federal entities will disclose information related to friable and nonfriable asbestos-related cleanup costs that are probable but not reasonably estimable in a note to the financial statements, consistent with SFFAS 5, SFFAS 6, and TR 2.

Table of Contents

Abbreviations

CAA	Clean Air Act
CERCLA	Comprehensive Environmental Response Compensation and Liability Act
CFO	Chief Financial Officer
CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
FAS	Financial Accounting Standard (FASB)
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FIN	FASB Interpretation Number
GAAP	Generally Accepted Accounting Principles
IPA	Independent Public Accountant
NESHAP	National Emissions Standards for Hazardous Air Pollutants
NOA	Naturally Occurring Asbestos
PP&E	Property, Plant, and Equipment
RCRA	Resource Conservation Recovery Act
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

Introduction

1. The purpose of this technical bulletin is to clarify the responsibility of all federal entities to report liabilities and related expenses arising from asbestos-related cleanup costs. This technical bulletin clarifies and elaborates on, but does not change, guidance previously provided in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant, and Equipment*, Chapter 4: Cleanup Costs; and Technical Release (TR) 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

Technical Guidance

Scope

2. What entities are affected by this technical bulletin?

3. This guidance affects all federal entities that own buildings, facilities, ships, or other tangible property, plant, and equipment (PP&E) that contain any form of asbestos.

4. What accounting practices are addressed in this technical bulletin?

5. This guidance clarifies the responsibility of all federal entities to report liabilities and expenses for asbestos-related cleanup costs and to disclose related information in the notes. Asbestos-related cleanup costs include cleanup costs related to both friable and nonfriable asbestos-containing material.

6. What is excluded from this technical bulletin?

7. This guidance regarding asbestos-related cleanup costs does not include naturally occurring asbestos (NOA) that can be found in soil, rocks and mines. NOA is contained in land, and land is considered to have an indefinite useful life. Therefore, NOA would appropriately be accounted for under the requirements of SFFAS 5.

8. This guidance does not pertain to contaminants or asset retirement obligations other than asbestos.

Background

9. What is asbestos?

10. Asbestos is a widely used, mineral-based material that is resistant to heat and corrosive chemicals (see sample list of asbestos-containing materials at Appendix C: Asbestos-Containing Materials). Typically, commercial asbestos appears as a whitish, fibrous material which may release fibers that range in texture from coarse to silky; however, airborne fibers that can cause health damage may be too small to see with the naked eye.

11. Section 112 of the Clean Air Act (CAA) requires the U. S. Environmental Protection Agency (EPA) to develop and enforce regulations to protect the general public from exposure to airborne contaminants that are known to be hazardous to human health. Asbestos was one of the first hazardous air pollutants regulated under Section 112. On March 31, 1971, EPA identified asbestos as a hazardous pollutant, and on April 6, 1973, EPA first promulgated the Asbestos National Emissions Standards for Hazardous Air Pollutants (NESHAP) in 40 CFR Part 61. The purpose of the asbestos NESHAP is to protect the public from asbestos emissions from certain sources.

12. Under the asbestos NESHAP, asbestos is categorized as either friable (any material containing more than 1 percent asbestos that, when dry, can be crumbled, pulverized, or reduced to powder by hand pressure) or nonfriable (any material containing more than 1 percent asbestos that, when dry, cannot be crumbled, pulverized, or reduced to powder by hand pressure). Friable asbestos poses more of an immediate health risk than nonfriable, but both forms must be properly contained and disposed of during repair, renovation, demolition, or other disturbance of the property. The terms friable and nonfriable are further defined in Appendix D: Definitions. From this point on in the document, the term asbestos or asbestos-containing materials will refer to both friable and nonfriable unless stated otherwise.

13. Exposure to asbestos can cause asbestosis (scarring of the lungs resulting in loss of lung function that often progresses to disability and to death); mesothelioma (cancer affecting the membranes lining the lungs and abdomen); lung cancer; and cancers of the esophagus, stomach, colon, and rectum.

14. What are cleanup costs?

15. Cleanup costs are 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. (SFFAS 6, par. 85)

16. Hazardous waste is 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. (SFFAS 6, par. 86)

17. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and postclosure costs. (SFFAS 6, par. 87)

18. What are asbestos-related cleanup costs?

19. Asbestos-related cleanup costs are the costs of removing, containing, and/or disposing of (1) asbestos-containing materials from property, or (2) material and/or property that consists of asbestos-containing material at permanent or temporary closure or shutdown of associated PP&E.[1]

20. While the term "hazardous waste" used in SFFAS 6, Chapter 4, par. 86 was informed by consulting environmental laws such as the Resource Conservation Recovery Act (RCRA), the general use of the term in federal accounting standards should not be construed as limiting the application of the standards solely to those materials meeting the definition of "hazardous waste" under RCRA. While asbestos is not explicitly listed as "hazardous waste" under RCRA, asbestos is listed as a hazardous air pollutant under the CAA and as a hazardous substance under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Therefore, the term "hazardous waste" as defined in SFFAS 6 and referenced in paragraph 16 of this technical bulletin includes asbestos for purposes of proper accounting treatment.

21. Why is this guidance being issued?

22. In March 2006, representatives from two CFO Act agencies informed FASAB staff that their independent public accountant (IPA) indicated that the agencies needed to reconsider their accounting for nonfriable asbestos for fiscal year 2006. The agencies noted that they had recognized an estimated liability for removal of asbestos posing an immediate health threat (i.e., friable), but had not prepared an estimate for the future removal of asbestos that does not pose an immediate health threat (i.e., nonfriable). The issue arose as a result of the Financial Accounting Standards Board's (FASB) issuance of FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47) in March 2005. Prior to

[1] Temporary closure or shutdown would also include the scheduled closure or shutdown of PP&E in order to conduct cleanup activities.

FIN 47, organizations following FASB standards did not consistently recognize liabilities for nonfriable asbestos. The agencies cited this inconsistency as well as the inconsistency among all federal agencies as the basis for not recognizing liabilities for nonfriable asbestos.

23. FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 provides that the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, FIN 47 requires that an entity recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated.

24. The issuance of FIN 47 prompted the agencies' IPA to revisit the guidance in SFFAS 5; SFFAS 6, Chapter 4: Cleanup Costs; and TR 2. FASAB staff conducted a conference call with several of the IPA's representatives, during which time the IPA's representatives communicated their concern that, under existing guidance in SFFAS 5, SFFAS 6, and TR 2, federal entities are not consistently reporting liabilities for asbestos-related cleanup costs.

Federal Entities Should Estimate Asbestos-Related Cleanup Costs and Recognize a Liability and Related Expense for those Costs that are Probable and Reasonably Estimable

General PP&E

Cleanup Cost Estimates

25. Should federal entities estimate asbestos-related cleanup costs?

26. Yes, federal entities should continue to follow the guidance contained in SFFAS 5, SFFAS 6, and TR 2 related to estimating obligations[2] for cleanup costs. Asbestos-related cleanup costs, as defined in paragraph 19, shall be estimated when the associated PP&E is placed

[2] The term obligation is used in this bulletin with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

in service. The estimate shall be included as part of the “estimated total cleanup cost.” (SFFAS 6 par. 94)

27. The estimate shall contemplate: (a) the cleanup plan, including level of restoration to be performed, current legal or regulatory requirements,[3] and current technology; and (b) 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. (SFFAS 6 par. 95)

28. Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing. (SFFAS 6 par. 96)

29. **Are there any costs that may be excluded from the estimate of asbestos-related cleanup costs?**

30. Yes, it is possible for certain types of nonfriable asbestos-containing material to remain nonfriable indefinitely; therefore, the estimate does not need to include nonfriable asbestos-containing roofing, flooring, siding, and other materials that when repaired, renovated, removed, contained, disposed of, or otherwise disturbed do not become friable and do not require additional costs above and beyond normal repair, renovation, removal, containment, or disposal costs to prevent them from becoming friable. However, if there are additional costs incurred to prevent the nonfriable asbestos-containing material from becoming friable or if it could potentially become friable as part of the repair, renovation, removal, containment, or disposal process, such costs should be included in the estimate of asbestos-related cleanup costs.

Liabilities

31. Should federal entities recognize a liability for asbestos-related cleanup costs?

32. Yes, federal entities should recognize a liability for asbestos-related cleanup costs if the liability is deemed to be both probable[4] and reasonably estimable. If the item is deemed to be probable, but not reasonably estimable, it should be disclosed in the notes to the financial statements, consistent with SFFAS 5, SFFAS 6, and TR 2.

[3] Laws and regulations approved as of the balance sheet date, regardless of the effective date of those laws and regulations, shall be considered.

[4] Per SFFAS 5, par. 33, probable is defined as “that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic.”

33. For assets placed in service after implementation of this technical bulletin, accumulation of the liability shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation [either permanently or temporarily]. (SFFAS 6 par. 98)

34. As reestimates are made, the cumulative effect of changes in total estimated asbestos-related cleanup costs related to current and past operations shall be recognized as expense and the liability adjusted in the period of the change in estimate (SFFAS 6 par. 99). In certain scenarios, such as when cleanup costs have been fully expensed, the reestimate may result in a credit to expense for that year.

35. As asbestos-related cleanup costs are paid, payments shall be recognized as a reduction in the liability for asbestos-related cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities. (SFFAS 6 par. 100)

Expenses

36. Should federal entities recognize the related expenses for asbestos-related cleanup costs?

37. Yes, a portion of estimated total asbestos-related cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as the basis for systematic and rational recognition of expense and accumulation of the liability. (SFFAS 6 par. 97)

38. For assets placed in service after the effective date of this technical bulletin, recognition of the expense shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation [either permanently or temporarily]. (SFFAS 6 par. 98)

39. Are federal entities required to account for liabilities related to general PP&E that are already in service at the date of implementation of this technical bulletin in the same manner as assets placed in service after implementation of this technical bulletin?

40. No, two implementation approaches have been provided for liabilities related to general PP&E that are already in service at the date of implementation of this technical bulletin: (1) A liability shall be recognized for the portion of the estimated total cleanup cost that is attributable to that portion of the physical capacity used or that portion of the estimated useful life that has passed since the PP&E was placed in service. The remaining cost shall be recognized in a systematic and rational manner based on use of the physical capacity of

the associated PP&E, whenever possible. (2) In situations where the related PP&E has been in service for a substantial portion of its estimated useful life, management may instead elect to recognize the estimated total cleanup cost as a liability upon implementation of this technical bulletin (this approach may only be used if costs are not intended to be recovered primarily through user charges). (SFFAS 6 pars. 104 and 97)

41. The offsetting charge for any liability for asbestos-related cleanup costs related to general PP&E in service at the date of implementation shall be made to net position of the entity. The amount of the adjustment shall be shown as a "change in accounting principle" in any statement of changes in net position that may be required. (SFFAS 6 par. 105 and SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*, pars. 12-13)

Stewardship PP&E (Heritage Assets and Stewardship Land)

42. How should federal entities report asbestos-related cleanup costs related to stewardship PP&E (Heritage Assets and Stewardship Land)?

43. Consistent with the treatment of the acquisition cost of stewardship PP&E (i.e., expensing in the period placed in service), the total estimated asbestos-related cleanup costs shall be recognized as expense in the period that the stewardship asset is placed in service and a liability established. (SFFAS 6 par. 101)

44. The liability shall be adjusted when the estimated total asbestos-related cleanup costs are reestimated. Adjustments to the liability shall be recognized in expense as part of "changes in estimated cleanup costs from prior periods." (SFFAS 6 par. 102) In certain scenarios, such as when cleanup costs have been fully expensed, the reestimate may result in a credit to expense for that year.

45. As asbestos-related cleanup costs are paid, payments shall be recognized as a reduction in the liability for asbestos-related cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities. (SFFAS 6 par. 103)

46. For stewardship PP&E that are in service at the date of implementation of this technical bulletin, the liability for asbestos-related cleanup costs shall be recognized and an adjustment made to the net position of the entity. The amount of the adjustment shall be shown as a "change in accounting principle" in any statement of changes in net position that may be required. The amounts involved shall be disclosed. (SFFAS 6 par. 106 and SFFAS 21 pars. 12-13)

Note Disclosures

47. With regard to asbestos-related cleanup costs, what should federal entities disclose in the notes to the financial statements?

48. Entities should disclose the following:

a. The sources (applicable laws and regulations) of asbestos-related cleanup requirements. The U.S. government-wide financial statements need not disclose the sources of cleanup requirements. (SFFAS 6 par. 107 and SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*," par. 12d)

b. The method for assigning estimated total asbestos-related cleanup costs to current operating periods (e.g., physical capacity versus passage of time). The U.S. government-wide financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods. (SFFAS 6 par. 108 and SFFAS 32 par. 12e)

c. For asbestos-related cleanup costs associated with general PP&E, the unrecognized portion of estimated total asbestos-related cleanup costs (i.e., the estimated total asbestos-related cleanup costs less the cumulative amounts charged to expense at the balance sheet date). SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E. (SFFAS 6 par. 109 and SFFAS 32 pars. 12f and 25)

d. Material changes in total estimated asbestos-related cleanup costs due to changes in laws, technology, or plans shall be disclosed. In addition, the portion of the change in estimate that relates to prior period operations shall be disclosed. The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations. (SFFAS 6 par. 110 and SFFAS 32 par. 12g)

e. The nature of estimates and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. (SFFAS 6 par. 111 and SFFAS 32 par. 12h)

49. For asbestos-related cleanup costs that are deemed to be probable but not reasonably estimable, the entity should disclose the presence of asbestos in its facilities and the inability to reasonably estimate an amount of the total cleanup costs.[5] SFFAS 32, par. 25, provides for disclosure requirements related to cleanup costs for the U.S. government-wide financial statements.

Effective Date

50. This technical bulletin is effective for reporting periods beginning after September 30, 2012. Earlier adoption is encouraged.

The provisions of this Technical Bulletin need not be applied to immaterial items.

[5] For example, asbestos may be contained within walls, flooring, or roofing and is inaccessible without destroying or weakening the existing structure or disturbing the asbestos, which would be undesirable. Without experience with a similar site and/or conditions, it may not be possible for the entity to reasonably estimate the cost to remove and dispose of the asbestos contained therein.

Appendix A: Basis for Conclusions

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 the Board's rules of procedure, as amended and restated through December 2003, 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.

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.

A1. In March 2006, a representative from one of the CFO Act agencies informed FASAB staff that its IPA requested that the agency reconsider its accounting for nonfriable asbestos-related cleanup costs for fiscal year 2006. The agency contacted FASAB due to the extensive work that would be required to estimate its liability for nonfriable asbestos-related cleanup costs and the implications for other federal agencies. The agency estimates that it has approximately 3,300 – 6,000 facilities that contain nonfriable asbestos that are not already included as part of its material environmental disposal liability calculation.

A2. FASAB staff was also contacted by a second CFO Act agency regarding the same issue. This second agency, which utilizes the same IPA as the first agency, stated that it was planning to prepare an estimate of its fiscal year 2006 asbestos liability for both friable and nonfriable asbestos-related cleanup costs absent guidance from the FASAB to the contrary.

A3. FASAB staff contacted the IPA directly and spoke with its representatives about the rationale for requesting the agencies to estimate a liability for nonfriable asbestos-related cleanup costs. The IPA representatives stated that the agencies had previously cited the inconsistency in reporting of these liabilities by federal entities and organizations that followed FASB standards as the basis for not recognizing a liability for nonfriable asbestos-related cleanup costs. The IPA representatives also stated that the issuance of FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), prompted it to revisit this obligation that federal entities have for future cleanup of asbestos because FIN 47 eliminated some of the inconsistency that the agencies had cited and required entities that follow FASB standards to recognize a liability for nonfriable asbestos.

In addition, the IPA representatives questioned whether existing FASAB pronouncements[6] would already require that both friable and nonfriable costs be recognized in the financial statements. The IPA representatives also stated that they believe there is a divergence in practice across the federal government, with some agencies reporting a liability for both friable and nonfriable asbestos-related cleanup costs in past years, while others have recognized only liabilities for friable cleanup costs.

A4. The agencies and the IPA representatives requested that the FASAB reconfirm existing guidance or issue new guidance on whether federal entities are required to recognize a liability for future cleanup of nonfriable asbestos.

A5. FIN 47, which was issued in March 2005, clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 states that the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, FIN 47 requires that an entity recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated.

A6. FIN 47 states that "uncertainty about whether performance will be required does not defer the recognition of an asset retirement obligation because a legal obligation to stand ready to perform the retirement activities still exists, and it does not prevent the determination of a reasonable estimate of fair value because the only uncertainty is whether performance will be required."[7] Application of FIN 47 clarifies that performance need not be probable and, therefore, may result in the recognition of more asset retirement obligations than if the determination were based on probability of performance. FIN 47 is effective no later than the end of the fiscal year ending after December 15, 2005.

A7. FIN 47, Appendix A, examples 3 and 4, contain specific examples that apply to cleanup of asbestos. Whether the facilities were acquired before or after the environmental regulations were put into place, the underlying requirement is the same. With regard to asbestos, Appendix A of FIN 47, states "Although the timing of the performance of the asset retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of asbestos in a special manner, and the obligating event occurs when the regulations are put

[6] SFFAS 5, SFFAS 6, and TR 2

[7] FIN 47, par. 5a.

in place [or the entity acquires the factory].” FIN 47 specifically states, “Although the entity may decide to abandon the factory and thereby defer settlement of the obligation for the foreseeable future, the ability to defer settlement does not relieve the entity of the obligation. The asbestos will eventually need to be removed and disposed of in a special manner, because no building will last forever.”

A8. Accounting for cleanup costs is specifically addressed in SFFAS 6, Chapter 4, as well as TR 2. The standards for cleanup costs in SFFAS 6 supplement the accounting requirements for liabilities in SFFAS 5, which requires that liabilities shall be recognized when three conditions are met: a past transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable. SFFAS 6, Chapter 4, requires that cleanup costs be estimated and charged to expense during each period that general property, plant, and equipment is in operation. TR 2 is intended to assist federal entities in determining probable and reasonably estimable liabilities related to their environmental cleanup responsibilities.

A9. SFFAS 6 addresses cleanup costs from federal operations known to result in hazardous waste. SFFAS 6 provides guidance when cleanup occurs at the end of the useful life of the PP&E or at regular intervals (scheduled phase cleanup) during that life. SFFAS 5 applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or where cleanup is an ongoing part of operations. TR 2 offers guidance on determining probable and reasonably estimable for environmental liabilities. The estimation of a liability for asbestos-related cleanup costs is not explicitly addressed by SFFAS 5, SFFAS 6, or TR 2, but staff believes it is covered under the requirements of these pronouncements.

A10. One key notion contained in FIN 47 that is not stated as explicitly in either SFFAS 6 or TR 2 is the notion that “no building will last forever”; it would be hard to support a claim that the federal government will be able to maintain a building forever without having to eventually cleanup the asbestos contained therein. The federal government is subject to the same laws and regulations regarding control and abatement of air pollution as nongovernmental entities.[8] Therefore, if one were to agree that the notion of probability of settlement applies to infinity rather than the foreseeable future, it is probable (more likely than not) that the federal government will be required to meet any legal obligations at some point in the future for the cleanup of asbestos in all of its facilities, whether they are sold, renovated, or demolished or collapse. Based on SFFAS 5 and 6 and TR 2, the question then becomes whether the federal liability for cleanup of asbestos is reasonably estimable.

[8] Toxic Substances Control Act (15 USC 2619) and Clean Air Act (42 USC 7418)

A11. TR 2, Section 2, provides guidance on determining "reasonably estimable" environmental liabilities. This guidance recommends completion of a remedial investigation/feasibility study upon which to base an estimate and/or experience with similar site and/or conditions. Estimated costs should be based on the cleanup plan, assuming current technology and current cost. These costs can include the costs to remove, contain, and/or dispose of the hazardous waste requiring cleanup. The SFFAS 5 measurement attribute – settlement cost (best represented by the current cost to cleanup) – differs significantly from the FIN 47 measurement attribute – fair value. Fair value incorporates the effects of uncertainty. Staff believes that settlement cost is more difficult to measure since it does not allow for different outcomes, each of which may be just as likely as the others.

A12. In the case of estimating asbestos-related cleanup costs in federal facilities, consideration needs to be given to the reasonable availability of relevant and reliable data upon which to base an estimate, the needs of the report users, the objective of reporting such information, and the materiality involved.

A13. As noted in paragraph 5, asbestos-related cleanup costs includes cleanup costs related to both friable and nonfriable asbestos-containing material. Under the asbestos NESHAP, friable asbestos is currently required by law to be removed, contained, and properly disposed of in the context of a demolition or renovation of a covered facility. There is no immediate requirement for the federal government to remove nonfriable asbestos in good condition that is not currently posing a health threat. However, the future repair, removal, renovation, demolition or other disturbance of asbestos-containing material may cause the asbestos to become friable and, because of limitation on the life of PP&E other than land, it is inevitable that these actions will occur. Thus, the event triggering the liability is the existence of asbestos in federal property, plant, and equipment, not a legal requirement to remove, contain, or dispose of the asbestos. Therefore, the accounting treatment for asbestos provided for in this technical bulletin is based on the best estimate of the costs that will be incurred in the future for removal, containment, or disposal of asbestos that exists in federal property, plant, and equipment as of the reporting date. The ability of the federal government to sell the federal property, plant, and equipment or otherwise dispose of it in the future without incurring any asbestos-related cleanup costs may affect measurement of the liability but does not negate the existence of the liability as of the reporting date.

A14. It is important to note that the requirement to estimate a liability for asbestos-related cleanup costs and the requirement to actually perform asbestos-related cleanup are two completely separate requirements. It is not within the scope or the intent of accounting standard-setters to establish what asbestos-related cleanup will be required and when. This must be determined by reference to applicable law. Furthermore, this technical bulletin does not intend to imply that recognizing a liability for asbestos-related cleanup costs in any way reflects a judgment about the legal obligation of the federal government for asbestos-related cleanup. The purpose of this technical bulletin is to provide guidance that will result in the more consistent and timely recognition of an accounting liability.

A15. In the past, some federal entities have cited the inconsistency in reporting of asbestos-related liabilities by federal entities and organizations that followed FASB standards as the basis for not recognizing a liability for nonfriable asbestos-related cleanup costs. Therefore, the effective date of this technical bulletin – for reporting periods beginning after September 30, 2009 – is established to allow federal entities the time to complete remedial investigation/feasibility studies or take similar steps in order to comply with this guidance. Earlier adoption is encouraged.

A16. A draft concepts statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements*, is currently under consideration by the Board and was issued as an exposure draft in early June 2006. This concepts statement proposes new definitions of five elements of accrual-basis financial statements – asset, liability, revenue, expense, and net position. These new definitions, if issued as final, would be used as the building blocks for new standards issued by the Board in the future. However, since the concepts statement will go through extensive due process before being finalized and subsequently used to develop new standards, this technical bulletin is being issued under the existing standards for the federal government. If changes are made to the cleanup standards in the future, the consideration of asbestos-related cleanup costs would be incorporated into the new standards accordingly.

A17. The exposure draft, Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, was issued June 1, 2006 with comments requested by June 30, 2006. Upon release of the exposure draft, notices and press releases were provided to The Federal Register, *FASAB News*, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past. To encourage responses, reminder notices were provided to the FASAB Listserv on June 20th and June 29th.

A18. Eleven comment letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others	1	3
Auditors	0	1
Preparers and financial managers	6	0

A19. In addition to the official count in paragraph A18, two federal agencies wrote that they had reviewed the exposure draft and determined that it required no changes or did not have a major impact to their current reporting practices.

A20. The Board considered responses to the exposure draft at its July 27, 2006 board meeting. The majority of the respondents agreed with the proposed guidance. Specific concerns raised by respondents related to asbestos being considered a hazardous waste, the lack of legal requirements to remove nonfriable asbestos in good condition, applicability of the technical bulletin to naturally occurring asbestos and other contaminants, and the issue of liability recognition versus note disclosure. Most concerns raised by respondents related to definition and scope of the proposed guidance. Clarifying language was added to address these concerns.

A21. Several respondents that were strongly opposed to the proposed guidance argued that because there is no legal requirement to cleanup nonfriable asbestos, it is not appropriate to estimate a liability for nonfriable asbestos. The Board has agreed that while legal enforceability may provide additional evidence that a liability exists, it is not a prerequisite. The guidance in this technical bulletin is requiring that the entity estimate the economic impact that the existence of asbestos has on the financial position of the entity. Therefore, if asbestos is present in any form in an entity's PP&E at year-end, the entity is required to estimate the costs that will be incurred at any point in the future to comply with all related laws and regulations regarding the asbestos already in existence as of the reporting date. The entity is only required to prepare a best estimate of costs that will eventually be incurred. The entity is not required to estimate costs for cleanup of asbestos that will never occur (e.g., nonfriable asbestos that will never become friable). Language was added to clarify the intent of the guidance.

A22. One respondent to the exposure draft stated that the technical bulletin should make a distinction between the treatment of cleanup costs for heritage assets and multi-use heritage assets. Based on a review of existing standards, it was noted that SFFAS 6 (as originally pronounced) provided for capitalization of certain costs related to multi-use heritage assets as general PP&E. In addition, SFFAS 6, Chapter 4, Cleanup Costs, differentiated between stewardship PP&E and general PP&E for purposes of estimating cleanup costs but did not specifically reference multi-use heritage assets. Although not explicitly stated, staff believes that it was the intent of the previous Board that the cleanup cost standards for general PP&E apply to all assets classified as general PP&E, including multi-use heritage assets.

A23. The Board has reviewed this technical bulletin, and a majority of its members do not object to its issuance.

Appendix B: Illustration of Asbestos-Related Cleanup Costs

This appendix illustrates one method of complying with the guidance in this technical bulletin.[9] The example shown in this appendix is for illustrative purposes only. Applying this technical bulletin may require consideration of estimated cost components other than those shown here.

Example of Accounting for Asbestos-Related Cleanup Costs

B1. A federal facility (general PP&E) was placed in operation in 1970. While the federal entity had previously recognized cleanup costs for friable asbestos, no recognition of nonfriable asbestos-related cleanup cost was made under past accounting policy. At the end of 2006, the entity adopts the accounting policies presented in this technical bulletin.

The following assumptions apply:

- The facility has an expected useful life of 50 years;
- The containment and removal of asbestos is required by state, local and Federal laws when the site is renovated, repaired, permanently or temporarily closed down, or otherwise disturbed; and,
- 2006 cost estimates are based on current cost for 2006.

RECOGNITION OF LIABILITY AMOUNTS FOR 2006 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 2006

The federal entity estimates the following total cleanup costs related to the containment and removal of nonfriable asbestos in its facility:

Inspection	$ 1,000
Sampling and Testing	10,000
Feasibility Study	5,000
Containment of Asbestos During Removal	12,000
Disposal of Asbestos	20,000
TOTAL ESTIMATED CLEANUP COST	$48,000

[9]The formulas used in this illustration are taken from SFFAS 6, Appendix D – *Illustration of Cleanup Cost*.

Calculation of Liability Amount to be Recognized upon Implementation

At the end of 2006, the estimated total cleanup costs were $48 million. The following calculations show the amounts that should have been recognized at the end of 2006 if the technical bulletin had been in effect since the facility began operation on October 1, 1970:

(a x b/c) – d = I where,

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[10]
c = total estimated capacity[11]
d = amount previously recognized as expense – beginning of period
I = liability to be recognized at the end of 2006

($48,000 x 36/50) - $0 = I
$48,000 x .72 - $0 = I
$34,560 = I

Dr. Change in Accounting Principle	$34,560	
Cr. Cleanup Liability		$34,560

To recognize estimated cleanup liability.

SUMMARY:

Financial Statement	**2006**
Change in Accounting Principle	$34,560
Liability	$34,560

[10] If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[11] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

Note regarding the second implementation approach:

If the entity elects to use the second implementation approach from paragraph 40 (recognition of the full liability amount upon implementation of the technical bulletin), the following entry would be made:

Dr. Change in Accounting Principle	$48,000	
Cr. Cleanup Liability		$48,000

This approach can only be used if the related PP&E has been in service for a substantial portion of its estimated useful life and costs are not intended to be recovered primarily through user charges.

Calculation of Annual Expense and Accrued Liability Amounts

In years 2007 through 2020, the following calculation shows the amount to be recognized annually:

(a x b/c) = I
($48,000 x 1/50) = I
($48,000 x .02) = I
$960 = I

Dr. Cleanup Expense $960

Cr. Cleanup Liability $960

To recognize estimated cleanup liability.

If the facility is renovated prior to 2020 (estimated end of useful life), the difference in the recognized liability and the total amount of the cleanup costs would be recognized as expense in the period of cleanup.

Payment of Cleanup Costs

One of the following entries would be made when cleanup costs are eventually incurred and subsequently paid, based on actual cleanup costs:

If cleanup costs equal outstanding liability (i.e., $48,000):

Dr. Cleanup Liability $48,000

Cr. Fund Balance with Treasury $48,000

If cleanup costs are less than outstanding liability (i.e., $43,000):

Dr. Cleanup Liability $48,000

Cr. Fund Balance with Treasury $43,000
Cr. Cleanup Expense $ 5,000

If cleanup costs are more than outstanding liability (i.e., $50,000):

Dr. Cleanup Liability	$48,000	
Dr. Cleanup Expense	$ 2,000	
Cr. Fund Balance with Treasury		$50,000

Appendix C: Asbestos-Containing Materials

Note: The following list does not include every product/material that may contain asbestos. It is intended as a general guide to show which types of materials may contain asbestos.

Sample List of Potential Asbestos-Containing Materials

Cement Pipes	Elevator Brake Shoes
Cement Wallboard	HVAC Duct Insulation
Cement Siding	Boiler Insulation
Asphalt Floor Tile	Breaching Insulation
Vinyl Floor Tile	Ductwork Flexible Fabric Connections
Vinyl Sheet Flooring	Cooling Towers
Flooring Backing	Pipe Insulation (corrugated air-cell, block, etc.)
Acoustical Plaster	Heating and Electrical Ducts
Decorative Plaster	Electrical Panel Partitions
Textured Paints/Coatings	Electrical Cloth
Ceiling Tiles and Lay-in Panels	Electric Wiring Insulation
Spray-Applied Insulation	Chalkboards
Blown-in Insulation	Roofing Shingles
Fireproofing Materials	Roofing Felt
Taping Compounds (thermal)	Base Flashing
Packing Materials (for wall/floor penetrations)	Thermal Paper Products
High Temperature Gaskets	Fire Doors
Laboratory Hoods/Table Tops	Caulking/Putties
Laboratory Gloves	Adhesives
Fire Blankets	Wallboard
Fire Curtains	Joint Compounds
Elevator Equipment Panels	Vinyl Wall Coverings
Construction Mastics (floor tile, carpet, ceiling tile, etc.)	Spackling Compounds

Source: Environmental Protection Agency at http://www.epa.gov.

Appendix D: Definitions

See Consolidated glossary in “Appendix E: Consolidated Glossary.”

Technical Bulletin 2009-1: Deferral of the Effective Date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*

Status

Issued	September 22, 2009
Effective Date	Effective upon issuance.
Affects	Technical Bulletin 2006-1, par. 50, by replacing the year "2009" with "2011."
Affected by	Technical Bulletin 2011-2, par. 2, deferred the effective date of Technical Bulletin 2006-1 for an additional year to fiscal periods beginning after September 30, 2012.

Summary

This Technical Bulletin defers for two years the effective date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs.* The guidance in Technical Bulletin 2006-1 will be effective for periods beginning after September 30, 2011.

Table of Contents

Technical Guidance

Scope

1. This guidance affects all federal entities that own buildings, facilities, ships, or other tangible property, plant, and equipment (PP&E) that contain any form of asbestos and present general purpose financial reports in conformance with Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Amendment of Technical Bulletin 2006-1

2. The effective date of the guidance on recognition and measurement of asbestos-related cleanup costs provided in par. 50 of Technical Bulletin 2006-1 is amended as follows:

> This Technical Bulletin is effective for reporting periods beginning after September 30, ~~2009~~2011. Earlier adoption is encouraged.

Effective Date

3. This Technical Bulletin is effective upon its issuance.

The provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

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 the Board's rules of procedure, as amended and restated through April 2004, 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.

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.

A1. In March 2009, FASAB staff members received a request from the federal agency members of the Accounting and Auditing Policy Committee (AAPC) disposal subgroup, excluding the audit representatives, that the implementation of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, be delayed until October 1, 2011 because of the reporting complexity, limited resources, and shifting priorities within the federal government due to the American Recovery and Reinvestment Act (ARRA). This request was not supported by all members of the AAPC disposal subgroup.

A2. The request stated that when Technical Bulletin 2006-1 was released with an effective implementation date for reporting periods after September 30, 2009, federal agencies began to evaluate their ability to estimate their asbestos-related cleanup cost liability. The subgroup's research into facility management practices has shown that agencies do not track asbestos in buildings, structures, or equipment except on a limited basis. Asbestos in building materials is only federally-regulated under limited conditions. Most asbestos is regulated by states resulting in decentralized data collection and management to address state-specific requirements. Additionally, there is limited guidance available on the collection and reporting of asbestos-related cleanup costs. For example, there is some confusion as to whether federal agencies will be able to model costs or whether they will need to assess each building and structure individually. Once AAPC completes and releases its implementation guidance on asbestos-related cleanup costs, agencies will need to develop agency-specific guidance, collect data, and prepare their cost estimates. In many cases, new or substantially modified tracking systems may be required.

A3. The request also noted that federal agencies now face the implementation of ARRA and its impact on federal land managers. For example, the Department of the Interior (DOI) has received more than $3 billion for infrastructure and other projects. This is a two-year funding that must be executed for creating jobs and boosting the economy. Many of the facility, engineering, and environmental staff that would work to develop asbestos cost estimates are now committed to executing this historic endeavor and would not be able to shift priorities to work on asbestos-related liability estimates.

A4. In considering the subgroup's request for delayed implementation of Technical Bulletin 2006-1, FASAB staff reviewed deferrals the FASAB has made in the past and discussed Technical Bulletin 2006-1 and the subgroup request at length with representatives from DOI's National Park Service, Office of Environmental Policy and Compliance, and Office of Finance; the Government Accountability Office; and the Department of State.

A5. When staff originally proposed Technical Bulletin 2006-1, the Board questioned why staff was providing such a long implementation period for a standard that was already in effect; the Technical Bulletin restates the requirements in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant and Equipment*, and specifically applies them to asbestos. Staff had responded that there was some conflicting guidance in place that had resulted in inconsistent reporting among agencies.[1] The extended implementation period was established to provide federal entities with the time to incorporate the resource requirements into their budget requests and complete remedial investigation / feasibility studies or take similar steps in order to comply with the guidance.

A6. However, there are several agencies that have been actively working toward compliance with the Technical Bulletin since it was issued in September 2006 and are encountering significant difficulties and unanswered questions. It was expressed to staff that the sheer volume of buildings and structures involved in the estimates is overwhelming. According to the fiscal year 2007 Federal Real Property Report published by GSA in May 2008, there are nearly 1,000,000 federal buildings and structures with a replacement value of over $1.5 trillion. The top five in number belong to Army (233,000), Interior (163,000), Navy (153,000), Air Force (149,000), and Transportation (59,000) and comprise 82 percent of the total buildings and structures.

A7. The individuals that staff spoke with have significant concerns about developing a methodology that will be accepted by the auditors and are working with limited resources. Agencies have encountered trouble finding contractors to assist them with developing estimates due to a number of factors, including conflict of interest concerns and a general lack of knowledge about where to begin. One of the primary reasons for the difficulties is due to the contingent nature of the cleanup requirements and other unknowns. Federal regulations do not require tracking of nonfriable asbestos and may not require removal even at the time of building renovation or demolition, depending on the material's condition and

[1] EITF 89-13, Accounting for the Cost of Asbestos Removal

the disposal method. In addition, the inability to visibly determine the presence of non-friable asbestos or validate its absence is a significant unknown, which some believe can not be adequately supported without testing. In discussions with staff, federal agency representatives also expressed that a good asbestos estimation model is not available to meet their purposes; many of the models out there require extensive input information and are more useful in developing a cost estimate once the extent of asbestos contamination is already known (i.e., post-survey). Agencies have received quotes on the additional costs that would be incurred to add nonfriable asbestos to condition assessment surveys (e.g., $2,000,000) and are hesitant to commit to the expense.

A8. Agencies have questioned whether they can eliminate from the population those buildings and structures of a smaller size that would incur significantly less asbestos cleanup costs but are uncertain whether that would be acceptable or not. Some agencies have thought about lumping like facilities together (i.e., lumping warehouses together and office buildings together) and then obtaining data on one percent of each grouping of facilities and extrapolate the data across the groupings; however, they again question whether this methodology would be acceptable to the auditors. One agency, which has approximately 20,000 structures, has invested more than $550,000 in contract costs to have approximately three percent of its structures estimated. From reviewing the initial contract costs and anticipating some economies of scale, the agency estimates spending between $350 to $500 per asset using the contractor's approach. Having only recently received the initial results from the contractor, the agency is reviewing the information to determine next steps, including data usability for modeling. The agency remains concerned about the overall implementation cost.

A9. In addition, staff is aware that the AAPC disposal subgroup is working on implementation guidance for the Technical Bulletin which may prove helpful to agencies in supporting their estimation methodologies and consistently reporting asbestos cleanup costs. Staff would encourage that this guidance be issued as quickly as possible to provide agencies with sufficient time to utilize it.

A10. While staff understands agencies' concerns about the reporting complexity, limited resources, and shifting priorities within the federal government due to ARRA, the most compelling reason for deferral of the effective date is the forthcoming implementation guidance being developed by the AAPC. Therefore, staff recommends that the effective date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, be deferred for two years to provide federal agencies with additional time to resolve implementation issues that have been identified since Technical Bulletin 2006-1 was issued.

A11. The exposure draft, *Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Costs*, was issued June 4, 2009, with comments requested by July 17, 2009. Upon release of the exposure draft, notices and press releases were provided to the Federal Register; *FASAB News,* the *Journal of Accountancy, AGA Today, The CPA Journal, Government Executive, The CPA Letter,* and *Government Accounting and Auditing Update;* the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and the Accounting and Auditing Policy Committee's General Property, Plant, and Equipment Task Force; committees of professional associations generally commenting on exposure drafts in the past; and past respondents to Technical Bulletin 2006-1 and others who had expressed an interest in the issue. To encourage responses, a reminder notice was provided to our Listserv on July 16, 2009.

A12. Seventeen comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	2	
Preparers and financial managers	13	

A13. The Board considered responses to the exposure draft at its August 27, 2009, public meeting. Sixteen of the 17 respondents were in favor of deferring the effective date. One respondent did not comment on the proposal. Since there was no opposition to the deferral proposal in the ED, staff recommended that the proposal be issued as final.

A14. The Board has reviewed this Technical Bulletin, and a majority of its members do not object to its issuance.

Appendix B: Abbreviations

AAPC	Accounting and Auditing Policy Committee
ARRA	American Recovery and Reinvestment Act
DOI	Department of the Interior
FASAB	Federal Accounting Standards Advisory Board
GSA	General Services Administration
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards

Technical Bulletin 2011-1: Accounting for Federal Natural Resources Other than Oil and Gas

Status

Issued	July 6, 2011
Effective Date	For periods beginning after September 30, 2013
Affects	None.
Affected by	None.

Summary

Technical Bulletin 2011-1 clarifies that federal entities should report the value of the federal government's estimated royalties and other revenue from federal natural resources that are (1) under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date in required supplementary information (RSI), consistent with the guidance contained in Statement of Federal Financial Accounting Standards 38, *Accounting for Federal Oil and Gas Resources*.

The guidance in this technical bulletin requires supplementary information and is effective for periods beginning after September 30, 2013. Earlier implementation is encouraged. It is the Board's intent that the information required by SFFAS 38 transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information required by SFFAS 38 will transition to basic information as financial statement recognition or note disclosure. It is anticipated that a similar determination would be made for natural resources other than oil and gas based on agencies' experiences implementing the guidance in this technical bulletin.

Table of Contents

Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, requires the value of the federal government's **estimated petroleum royalties**[1] from the production of federal oil and gas **proved reserves** to be reported in required supplementary information (RSI) as part of a discussion of all significant **federal oil and gas resources** under management by the entity.

2. This technical bulletin clarifies that federal entities should report the value of the federal government's estimated royalties and other revenue for other **federal natural resources**[2] that are (1) under long-term lease, long-term contract or other long-term agreement[3] and (2) **reasonably estimable** as of the reporting date in RSI, consistent with the guidance contained in SFFAS 38 for federal oil and gas proved reserves.

Materiality

3. The provisions of this technical bulletin 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

4. The guidance in this technical bulletin is effective for periods beginning after September 30, 2013. Earlier implementation is encouraged.

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[1] Terms defined in the Glossary or Appendix C are shown in **bold-faced type** the first time they appear.

[2] The term "federal natural resources" should be viewed with its general meaning as defined in the glossary.

[3] The shortened phrase "lease, contract, or other long-term agreement" is used throughout the remainder of this document to refer to all such long-term arrangements. Long-term is defined as longer than five years and applies to the original term of outstanding leases, contracts, or other long-term agreements as of the reporting date.

5. It is the Board's intent that the information required by SFFAS 38 transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information required by SFFAS 38 will transition to basic information as financial statement recognition or note disclosure. It is anticipated that a similar determination would be made for natural resources other than oil and gas based on agencies' experiences implementing the guidance in this technical bulletin.

Technical Guidance

Scope

6. **What entities are affected by this technical bulletin?**

7. This guidance applies to federal entities that (a) manage federal natural resources and (b) prepare general purpose federal financial reports, including the consolidated financial report of the U.S. Government, in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board (FASB)*.

8. **What accounting practices are addressed in this technical bulletin?**

9. This guidance clarifies the responsibility of federal entities to report the value of the federal government's estimated royalties and other revenue from federal natural resources under lease, contract or other long-term agreement in RSI, consistent with the guidance contained in SFFAS 38 for federal oil and gas resources.

10. **What are federal natural resources?**

11. Federal natural resources are resources that occur in nature (including **nonrenewable natural resources** and **renewable natural resources**) and meet all of the following criteria:

    a. the federal government may exercise sovereign rights over the resources with respect to exploration and exploitation,

    b. the federal government has the authority to derive revenues from the resources for its use, and

c. the resources are contained on federal lands or the federal government substantially manages and/or controls[4] the resources.[5]

Required Supplementary Information (RSI)

12. **How should federal entities apply the general principles of SFFAS 38 to the different types of federal natural resources other than oil and gas that are under management by the entity?**

13. Federal entities are required to apply the general principles of SFFAS 38 through the guidance provided in this technical bulletin and report the value of the federal government's estimated royalties and other revenue from nonrenewable resources that are (1) *under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date*. This is consistent with SFFAS 38 requirements for reporting on federal oil and gas proved reserves.[6]

14. Federal entities are not required to, but may, apply the guidance in this technical bulletin and report the estimated value of other federal natural resources, including renewable natural resources, **electromagnetic spectrum**, or other nonrenewable resources that are not under lease, contract, or other long-term agreement.

15. The narrative discussion required in paragraph 27f should include those federal natural resources that are significant to the reporting entity but not required to be reported in the schedule described in paragraph 17 (for example, they are not measurable[7] or not under lease, contract, or other long-term agreement).

[4] "Substantially manages and/or controls" means that the federal government manages and/or controls access to the economic benefits to be derived from the resources and, therefore, can obtain them and deny or regulate the access of other entities to them (Statement of Federal Financial Accounting Concepts (SFFAC) 5, par. 22). This criterion would not be met if the federal government's role is limited to the custodian of collections. For example, royalties collected by the federal government from resources produced from Indian lands on behalf of individual Indians and Indian tribal organizations from leases that are negotiated and signed by the individual Indians and Indian tribal organizations are considered custodial in nature and not federal resources.

[5] Adapted from SFFAS 38, available at http://www.fasab.gov/codifica.html; last accessed September 14, 2010.

[6] While SFFAS 38 does not specifically address other types of federal natural resources, the Board believes that SFFAS 38 should be considered when applying the hierarchy of generally accepted accounting principles to other types of federal natural resources (SFFAS 38, paragraph 9).

[7] As used in SFFAC 5, paragraph 5, the term measurable means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.

Component Entity RSI

16. **What should be reported in component entity RSI for federal natural resources other than oil and gas?**

17. The value of the federal government's estimated royalties and other revenue from the reporting entity's federal natural resources that are (1) under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date should be reported in a schedule in RSI as part of a discussion of the significant federal natural resources under management by the entity (SFFAS 38, paragraph 15).

18. The value of the federal government's estimated royalties and other revenue from the reporting entity's federal natural resources under lease, contract, or other long-term agreement should be reported by major types of natural resources. Resources may be further divided by subtype of commodity and calculated separately if material differences would otherwise result. Each of the individual calculations should be reported separately and summed together to arrive at the reporting entity's total estimated natural resources under lease, contract, or other long-term agreement (SFFAS 38, paragraph 21).

19. If a majority of the reporting entity's estimated revenue from natural resources under lease, contract, or other long-term agreement is designated to be distributed to others, the value of the revenue to be distributed should be estimated and reported in a schedule of estimated revenue to be distributed to others (SFFAS 38, paragraph 25).

20. **How should the value of federal natural resources be determined?**

21. The estimates that are developed should approximate the **present value** of future receipts of federal natural resources that are (1) under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible (SFFAS 38, paragraph 17).

22. Discount rates as of the reporting date for present value measurements of federal natural resources should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted (SFFAS 38, paragraph 18).

23. The reporting entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. While the entity's own assumptions about future cash flows may be used, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and

Product Accounts. If the entity's own assumptions do not reflect data that are consistent with sources independent of the reporting entity, an explanation of why the entity's own assumptions are preferred should be provided (SFFAS 38, paragraph 19).

24. The preferred measurement method for valuing the reporting entity's federal natural resources is the present value of future receipts on federal natural resources that are (1) under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date using a risk-free discount rate as described in paragraph 22; however, alternative methods for measuring **fair value** or current price may be acceptable if it is not reasonably possible to estimate present value of future federal receipts using the methodology described in paragraphs 21 through 24 (SFFAS 38, paragraph 22)[8].

25. Once established, the estimation methodology should be consistently followed and explained in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be explained (SFFAS 38, paragraph 23).

26. **What else should be reported?**

27. The reporting entity should provide the following as a narrative[9] to the schedules presented as RSI:

    a. A concise statement explaining how the management of the reporting entity's federal natural resources is important to the overall mission of the entity.

    b. A brief description of the entity's stewardship policies for federal natural resources (e.g., the guiding principles established to: assess resource areas; offer those resources to interested developers; sell and assign leases to winning bidders; administer the leases; collect bonuses, rents, and royalties; and distribute the collections consistent with statutory requirements, prohibitions, and limitations governing the entity).

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[8] Calculating the present value of future federal receipts employs the use of a number of estimates; unforeseen circumstances may result in situations where it is not possible for the entity to reasonably estimate the present value of future federal receipts. In these situations, it may be possible to estimate current price. Current price, sometimes referred to as a "fresh-start" or "remeasured" price, is a general term for various attributes measured as of a financial statement date subsequent to the period of initial recognition, including replacement price, market price, and settlement price.

[9] Quantitative data is not required to be reported as part of the narrative discussion unless specifically required as part of a display that accompanies the narrative discussion (for example, in par. 27e, where quantitative information is required in display format).

c. A narrative describing the estimation methodology used to calculate the value of the federal reporting entity's natural resources under lease, contract, or other long-term agreement. At a minimum, the narrative explanation should include a "plain English" explanation of the measurement attribute or method, the significant assumptions incorporated into the estimate, and any significant changes to the estimation methodology, including the underlying assumptions, from the prior year. As required by paragraph 25, the nature and reason for any changes, as well as the effect of the changes, should be explained.

d. A reference to the source reports used to calculate the value of the federal reporting entity's estimated natural resources under lease, contract, or other long-term agreement.

e. A narrative describing and a display showing the sales volume, the sales value, the royalty or other revenue, and the estimated value of **royalty relief** or other **foregone revenue**, if any, that resulted from the extraction and removal of federal natural resources under management by the reporting entity for the reporting period.

f. A narrative describing other significant natural resources under management by the federal reporting entity that are not required to be reported in the schedule described in paragraph 17 (for example, they are not measurable[10] or not under lease, contract, or other long-term agreement). The narrative should be sufficient to enable the financial statement reader to gain an understanding of the full extent of significant natural resources under management by the entity, including resources contained on land that has been legislatively or administratively withdrawn from leasing (SFFAS 38, paragraph 28).

Consolidated Financial Report of the U.S. Government RSI

28. **With regard to federal natural resources other than oil and gas, what should be reported in the consolidated financial report of the U.S. Government?**

29. The governmentwide entity should provide the following information related to federal natural resources in RSI as part of a discussion of the significant federal natural resources under management by the federal government:

a. A concise statement explaining the nature and valuation of federal natural resources.

[10] See footnote 7.

b. The asset value of federal natural resources under lease, contract, or other long-term agreement by the types identified for use in calculating the value of the federal government's estimated royalties and other revenue from natural resources under lease, contract, or other long-term agreement as of the end of the reporting period (see paragraph 18). Related groups of resources that do not warrant classification and presentation in separate categories should be aggregated.

c. A reference to specific agency reports for additional information about federal natural resources (SFFAS 38, paragraph 29).

Effective Date

30. This technical bulletin is effective for periods beginning after September 30, 2013. Earlier implementation is encouraged.

31. It is the Board's intent that the information required by SFFAS 38 transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information required by SFFAS 38 will transition to basic information as financial statement recognition or note disclosure. It is anticipated that a similar determination would be made for natural resources other than oil and gas based on agencies' experiences implementing the guidance in this technical bulletin.

The provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

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 the Board's rules of procedure, as amended and restated through December 2003, 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.

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.

Project History

A1. In April 2010, FASAB issued SFFAS 38, *Accounting for Federal Oil and Gas Resources*. SFFAS 38 requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves to be reported in a schedule of estimated federal oil and gas petroleum royalties. SFFAS 38 also requires the value of estimated petroleum royalty revenue designated for others to be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented in required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity.

A2. Federal lands contain a variety of natural resources that are not specifically addressed by SFFAS 38, including coal, gold, and silver, as well as timber and grazing rights. Originally, the Board intended to address each category of resources in separate phases as noted in paragraph A2 of SFFAS 38. Although in principle a broader application was desirable to several Board members, the majority believes that the Board has already devoted a substantial amount of time to the oil and gas standard and developing additional guidance for the other types of resources would significantly delay implementation of a broad standard. Therefore, because federal oil and gas resources represent the most significant portion of all federal natural resources, the majority of members felt it was important to begin recognizing them as soon as possible.

A3. Nonetheless, the majority of the members believe that the standards developed for federal oil and gas resources may serve as a good general framework for other categories of federal natural resources.[11] Therefore, while SFFAS 38 does not specifically address other types of federal natural resources, the Board believes that SFFAS 38 should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board explicitly states that SFFAS 38 does not require or preclude entities from reporting information about other types of federally-owned natural resources; however, members believe SFFAS 38 should be considered in conjunction with SFFAS 7, *Accounting for Revenue and Other Financing Sources*, when applying SFFAS 34 to other types of federally-owned natural resources.[12]

A4. During deliberations on SFFAS 38, the Board explicitly directed staff to apply the requirements of SFFAS 38 to other types of natural resources through the issuance of a technical bulletin. In doing so, the board members noted that the technical bulletin comment period would provide federal entities with an opportunity to comment on the standards as they would apply to the specific natural resources under their management.

Components of Federal Natural Resources

A5. *Figure 1, Components of Federal Natural Resources Other than Oil and Gas*, presented on the next page identifies the universe of federal natural resources (total resources). Total resources incorporate “original in-place” resources, that is, resources in the earth before human intervention. The components are first separated into “undiscovered resources” and “discovered resources.”

A6. The terms in Figure 1 are defined in Appendix C: Technical Terms under the subheading “Definitions of Federal Natural Resources Components and Subcomponents.”

[11] SFFAS 34, Paragraph 7.

[12] SFFAS 7, par. 45, requires, in instances where there are virtually no costs incurred in earning exchange revenue, that federal entities recognize the revenue as a financing source on the statement of changes in net position, rather than the statement of net cost (SFFAS 38, Paragraph 9).

Figure 1 – Components of Federal Natural Resources Other than Oil and Gas

Accounting Treatment	Components of Federal Natural Resources Other than Oil and Gas								
	Undiscovered Resources			Discovered Resources					
	Non-Recoverable	Recoverable		Not Available for Sale or Lease		Available for Sale or Lease			
		Undiscovered Conventionally Recoverable Resources	Undiscovered Economically Recoverable Resources	Legislatively Withdrawn	Administratively Withdrawn	Other	Planned to be Offered	Under Contract but Not Conveyed[13]	
Existing Accounting Treatment Before SFFAS 38								Bonus bid, rent, royalty and other revenue accounted for by reporting entity either as (1) exchange revenue on the SNC or as (2) as a financing source on the CFR and reporting entity SOCNP[14]	
New Accounting Treatment Based on SFFAS 38				• Provide a narrative disclosure in Required Supplementary Information (RSI) of the full extent of natural resources under management by the reporting entity, including resources contained on land that has been legislatively or administratively withdrawn from leasing				• Revenue continues to be accounted for as either exchange revenue on the SNC or a financing source on the SOCNP • Various RSI disclosures	
								Not Reasonably Estimable	Reasonably Estimable[15]
									• Asset value and revenue to be distributed to others reported as RSI

[13]"Under Contract" encompasses lease, contract, or other long-term agreement. "Not Conveyed" refers to the portion of actual resources under contract that have not yet been physically extracted or removed from federal lands.

[14]SNC = statement of net cost, CFR = consolidated financial report of the U.S. Government, and SOCNP = Statement of Operations and Changes in Net Position.

[15]Under contract and reasonably estimable is substantially equivalent to "proved reserves" under SFFAS 38.

Renewable Resources

A7. Staff believes that it may not be appropriate to apply the guidance in this Technical Bulletin to renewable natural resources. Based on staff's review of the major characteristics of renewable resources, renewable resources may not be similar enough to oil and gas royalties that an appropriate analogy can be made under the principles contained in SFFAS 38. For example, costs to develop certain renewable resources may be incurred by the federal government while revenues may relate to annual production rather than extraction of long-standing reserves. Such revenue-producing renewable resources that result in exchange revenue that is matched against the economic cost of operations may not benefit from the additional reporting requirements of SFFAS 38. Therefore, federal entities are not required to, but may, apply the guidance in this technical bulletin to renewable natural resources.

Electromagnetic Spectrum

A8. Staff believes that auctions of the electromagnetic spectrum may not be similar enough to oil and gas royalties that an appropriate analogy can be made under the principles contained in SFFAS 38. The spectrum is closer to a renewable resource in that it is inexhaustible in duration but limited in the amount of spectrum that is available per unit of time. Proceeds from auctions of the spectrum are not received on a consistent basis from year to year since the need for auction depends on the mutual exclusivity of the applications received in any given year (for example, auction proceeds were $16.8 billion, $1.8 billion, $13.9 billion, and $104 million in fiscal years 2009, 2008, 2007, and 2006, respectively). In addition, the asset that is being sold is the right to use the spectrum for a period of time, similar to a standard operating lease; nothing is being used up or depleted. Furthermore, auction proceeds are one-time payments made by each auction's winner; they are not made over the course of a lease, contract, or other long-term agreement. Therefore, federal entities are not required to, but may, apply the guidance in this technical bulletin to the electromagnetic spectrum.

A9. The Board decided to add accounting for the electromagnetic spectrum to its list of potential projects for consideration at future agenda-setting sessions. If the project is selected for the agenda, the Board would determine if additional guidance is warranted (see SFFAS 7 paragraphs 145, 278 and 279). As of the issuance of this technical bulletin, this potential project has not been added to the Board's five-year agenda.

Other Natural Resources

A10. The guidance in this technical bulletin applies the general principles of SFFAS 38 to other natural resources where staff believes an analogy can be drawn. While staff thought it was appropriate to limit the guidance of this technical bulletin to those resources that most closely analogized with federal oil and gas proved reserves, federal entities may believe that additional reporting on other natural resources under its management is appropriate. Therefore, federal entities are not required to, but may, apply the guidance in this technical bulletin to other natural resources that are not under lease, contract, or other long-term agreement.

Due Process

A11. The Exposure Draft (ED), Technical Bulletin 2011-1, *Accounting for Federal Natural Resources Other Than Oil and Gas*, was released on January 5, 2011, with comments requested by January 31, 2011.

A12. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A13. This broad announcement was followed by direct e-mailings of the press release to:

a. Relevant congressional committees: Senate Committee on Energy and Natural Resources, Senate Committee on Finance, House Committee on Financial Services, and House Committee on Natural Resources;

b. Public interest groups and think tanks: Alliance to Save Energy, the Brookings Institution, the Cato Institute, the Center on Budget and Policy Priorities, Citizens Against Government Waste, The Concord Coalition, The Heritage Foundation, National Parks Conservation Association, Natural Resources Defense Council, OMB Watch, Resources for the Future, the Sierra Club, the Urban Institute, and World Resources Institute;

c. Respondents to SFFAS 38 and related EDs (or their successors);

d. Agencies that manage and/or account for federal natural resources: Department of the Interior (DOI) Office of the Secretary; DOI Bureau of Land Management ; DOI Bureau of Ocean Energy Management, Regulation and Enforcement; DOI U.S. Geological Service; Department of Agriculture (USDA), Deputy CFO; and USDA Forest Service.

A14. To encourage responses, reminder notices were provided to the FASAB email listserv on January 28, 2011, and February 8, 2011.

Comment Letters

A15. Eight comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others	0	2
Auditors	1	0
Preparers and financial managers	5	0

A16. Responses to the exposure draft were considered at the February 24, 2011, public Board meeting. Staff did not rely on the number 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 and staff considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A17. Respondents generally agreed with the proposed guidance; the respondents that expressed the most reservations are the ones that would need to determine whether they have material natural resources that are (1) under lease, contract, or other long-term agreement and (2) reasonably estimable as of the reporting date. Staff does not believe that an agency's current inability to determine materiality should be a barrier to issuing the proposal because it would seem that agencies that are leasing the federal government's natural resources over a long period of time (greater than five years) should have a reasonable idea of the amount that the federal government should be receiving for those nonrenewable natural resources assuming stable economic conditions and where the reasonably estimable hurdle is overcome. If the agencies do not know whether something is material or not, federal financial reporting objectives such as being able to determine whether the federal government is being a good steward cannot be met.

A18. One of the respondents stated that they do not believe the information is reasonably estimable. If the information is not reasonably estimable, it would not meet one of the primary requirements for being included in the schedule (under lease, contract, or other long-term agreement **and reasonably estimable as of the reporting date**) and would only need to be included in the narrative discussion proposed in paragraph 27f.

A19. One respondent stated that significant audit costs could be incurred by providing information to the auditor that confirms "immateriality" and "completeness" especially if information is not centrally available. Because materiality assessments require both qualitative and quantitative judgments, specific guidance limiting preparer and auditor considerations of information would not be appropriate.

A20. One respondent stated that the technical bulletin should explain the rationale for using the five-year term as the basis for the definition of "long-term." Staff selected a five-year term based on the definition of "long-term assumptions" that was established in SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, which states, "Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more."

Meeting with DOI Representatives

A21. At the February meeting, several board members expressed significant concern about the potential cost of the proposal based on DOI's letter and the conflicting views presented by DOI bureaus. The members asked for additional information from DOI.

A22. Staff asked DOI to clarify its response to the Exposure Draft and invited representatives from DOI to the April meeting to allow the board members to ask questions about DOI's response.

A23. As a result of DOI's revised response received on April 15, 2011, and its meeting with the Board, it was determined that DOI had interpreted the technical bulletin as requiring an estimate of the entire asset instead of just the estimated inflows to the federal government. Board members believe, and DOI confirmed, that it should be able to obtain this information by reviewing the actual lease agreements and developing an estimate based on the terms of the leases. DOI stated that it believes it can gather the information but would like to have until 2014 to implement the requirements of the technical bulletin because its resources are already dedicated to implementation of SFFAS 38 and rolling out a new core financial system. Staff agreed with a fiscal year 2014 implementation date and revised the effective date accordingly.

Board Review

A24. The Board has reviewed this Technical Bulletin, and a majority of its members do not object to its issuance.

Appendix B: Abbreviations

CFR	Consolidated Financial Report of the U.S. Government
DOI	U.S. Department of the Interior
EIA	U.S. Energy Information Administration
FASAB	Federal Accounting Standards Advisory Board
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SNC	Statement of Net Cost
SOCNP	Statement of Operations and Changes in Net Position
U.S.C.	United States Code
USDA	U.S. Department of Agriculture

Appendix C: Technical Terms

The terms explained in Appendix C have specific application to federal natural resources and may be useful in applying the requirements of this Technical Bulletin.

Definitions of Federal Natural Resources Components and Subcomponents

Provided below are definitions used in this technical bulletin to describe federal natural resource components and subcomponents.[16] This section of Appendix C defines the terms used in *Figure 1 – Components of Federal Natural Resources Other than Oil and Gas*.

Undiscovered Resources

Resources surmised to exist on the basis of broad geologic knowledge and theory.[17]

- Undiscovered Non-Recoverable Resources – The portion of undiscovered federal natural resources not currently considered to be recoverable. A portion of these resources may become recoverable in the future as commercial circumstances change, technological developments occur, or additional data are required.

- Undiscovered Recoverable Resources – The portion of undiscovered federal natural resources that are estimated to exist in favorable geologic settings.[18]

    - Undiscovered Conventionally Recoverable Resources: The portion of undiscovered federal natural resources that is producible, using present or reasonably foreseeable technology, without any consideration of economic feasibility.

    - Undiscovered Economically Recoverable Resources: The portion of undiscovered federal natural resources that is economically recoverable under imposed economic scenarios.

[16] Unless otherwise noted, definitions in this section were adapted from SFFAS 38, Appendix D: Technical Terms.

[17] Adapted from the Energy Information Administration (EIA) Glossary, available at http://www.eia.doe.gov/glossary/; last accessed October 4, 2010.

[18] Ibid.

Discovered Resources

Resources whose location and quantity are known or estimated from specific geologic evidence.

- Not Available for Sale or Lease – Resources that are not available for sale or transfer because they have been legislatively or administratively withdrawn.

    - Legislatively withdrawn resources: Those resources that by law can not be offered for transfer to private entities (e.g., resources in Wilderness Areas, National Parks, and Recreation Areas).

    - Administratively withdrawn resources: Those resources in areas which by law could be offered for transfer to private entities, but which have been administratively withdrawn. Such resources could be made available for future transfer by administrative decision without change in law (e.g., locatable minerals in scenic or recreational areas).

- Available for Sale or Lease – Those resources that are available for sale or transfer because they have not been legislatively or administratively withdrawn.

    - Planned to be offered: Resources planned to be offered are those resources for which it has been determined that specific types of resources in specific locations or within specific areas will be made available for sale or transfer to private entities (e.g., areas open to claims under the Mining Law of 1872).

    - Under contract but not conveyed: Resources "under contract" are resources that have been offered for sale through a lease, contract, or other long-term agreement but have not yet been conveyed to the purchaser.

        - *Reasonably Estimable*: Reasonably estimable resources under contract but not yet conveyed are those resources that are under lease, contract, or other long-term agreement; known to exist as of year-end; and for which the value can be reasonably estimated.

        - *Not Reasonably Estimable*: Not reasonably estimable resources under contract but not conveyed are those resources that are under lease, contract, or other long-term agreement; known to exist as of year-end; but for which the value cannot be reasonably estimated.

    - Other: Other resources available for sale are those resources which are neither restricted by law nor administratively withdrawn, are outside of areas for which there are contracts to convey a resource, and are outside of areas for which the determination has been made to offer the resource for sale.

End of the terms in Figure 1 that are defined under the subheading "Definitions of Federal Natural Resources Components and Subcomponents."

Other Definitions

Electromagnetic Spectrum: The range of electromagnetic radio frequencies (waves per second) used to transmit sound, data, and video across the country. It carries voice between cell phones, television shows from broadcasters to the television, and online information from one computer to the next, wirelessly. The electromagnetic spectrum includes (from longest wavelength to shortest): radio waves, microwaves, infrared, optical (or visible), ultraviolet, x-rays, and gamma-rays.[19]

Estimated Petroleum Royalties: The estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources.

Federal Natural Resources: Federal natural resources are resources that occur in nature (including nonrenewable and renewable natural resources) and meet all of the following criteria: (a) the federal government may exercise sovereign rights over the resources with respect to exploration and exploitation; (b) the federal government has the authority to derive revenues from the resources for its use; and, (c) the resources are contained on federal lands or the federal government substantially manages and/or controls the resources.[20]

Federal Oil and Gas Resources: Oil and gas resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

Foregone Revenue: Foregone revenue is the reduction, modification, or elimination of any royalty or other fee to operators to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases.[21]

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[19] Federal Communications Commission, available online at http://reboot.fcc.gov/reform/systems/ spectrum-dashboard/about; last accessed September 22, 2010.

[20] Adapted from SFFAS 38, available at http://www.fasab.gov/codifica.html; last accessed September 14, 2010.

[21] Adapted from definition of royalty relief from 43 U.S.C. § 1337(a).

Nonrenewable Natural Resources: Resources that cannot be easily made or "renewed," such as oil, natural gas, and coal.[22]

Proved Reserves: For crude oil and gas, proved reserves are the estimated quantities that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. For lease condensate and natural gas plant liquids, proved reserves are the estimated quantities demonstrated with reasonable certainty to be recoverable in future years in conjunction with the production of proved gas reserves, under existing economic and operating conditions. The total quantity of proved reserves is calculated by adding the quantity of reserves reported as revisions and adjustments, net of sales and acquisitions, total recoveries and deducting estimated production during the report year.

Renewable Natural Resources: Resources that are naturally replenishing but flow-limited. They are virtually inexhaustible in duration but limited in the amount of resources that are available per unit of time. Renewable resources include, but are not limited to, timber, biomass, hydropower, geothermal energy, solar, wind, water, fish, wildlife, ocean thermal, wave action, and tidal action.[23] The opposite of renewable is depletable, which refers to resources that are diminished after use, such as coal, oil, and gas.

Royalty Relief: Existing statutes authorize DOI to grant royalty relief to operators on the production of oil and gas resources from federal oil and gas leases. Royalty relief is the reduction, modification, or elimination of any royalty to operators to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases.[24]

[22] Adapted from EIA Glossary, available at http://www.eia.doe.gov/glossary/; last accessed May 10, 2011.

[23] Adapted from EIA Glossary.

[24] 43 U.S.C. § 1337(a).

Technical Bulletin 2011-2: Extended Deferral of the Effective Date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*

Status

Issued	September 22, 2011
Effective Date	Effective upon issuance.
Affects	Technical Bulletin 2006-1, par. 50, by replacing the year “2011” with “2012.”
Affected by	None.

Summary

This Technical Bulletin extends the deferral of the effective date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, by one year. The guidance in Technical Bulletin 2006-1 will be effective for reporting periods beginning after September 30, 2012.

Table of Contents

Technical Guidance

Scope

1. This guidance affects all federal entities that own buildings, facilities, ships, or other tangible property, plant, and equipment (PP&E) that contain any form of asbestos and present general purpose federal financial reports in conformance with generally accepted accounting principles, as defined by Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Amendment of Technical Bulletin 2006-1

2. The effective date of the guidance on recognition and measurement of asbestos-related cleanup costs provided in par. 50 of Technical Bulletin 2006-1 is amended as follows:

   This technical bulletin is effective for reporting periods beginning after September 30, ~~2011~~2012. Earlier adoption is encouraged.

Effective Date

3. This Technical Bulletin is effective upon its issuance.

The provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

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 the board's rules of procedure, as amended and restated through April 2004, 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.

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.

Background

A1. On April 15, 2011, staff received a formal letter from the U.S. Department of the Interior (DOI or Interior), requesting that the board revisit Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, to consider permitting agencies to report the estimated asbestos-related cleanup liability in required supplementary information (RSI) for several fiscal years until more data becomes available to make a more reliable estimation for asbestos-related cleanup costs.

A2. The request stated, "To comply with the requirements of [Statement of Federal Financial Accounting Standards (SFFAS)] 6 and [Technical Bulletin] 2006-1, the Department of the Interior (Interior) began compiling cost data related to the cleanup of friable and non-friable asbestos. To date, Interior has surveyed more than 3,000 buildings and structures at a cost of more than $2.5 million. Interior owns approximately 160,000 buildings and structures. To estimate the total asbestos-related cleanup costs for this large inventory of real property, Interior has chosen the cost modeling approach based on existing survey data. The modeling approach, though the least costly of all methodologies, poses several problems for Interior. First, the cost factor developed based on existing surveys is not representative for all asset types. Actual surveys performed by Interior were primarily on buildings, and Interior owns more than 106,000 structures, for which little or no actual cleanup data is available. Second, although Federal Accounting Standards Advisory Board (FASAB) allows the use of information from industry-specific cost estimation publications or standardized costs factors developed for each state, there is little or no actual asbestos cleanup data available for certain asset groups. For example, there is no actual asbestos-related cleanup data available for monuments and other types of heritage assets owned by Interior."

A3. DOI's request went on to state, "In order to continue with this approach, Interior would need to perform a significant number of additional surveys for certain assets groups and this presents a major challenge. In light of current resource constraints, coupled with probable future budget cuts, the requirement to complete additional surveys would impose a significant financial hardship for Interior. We also need to consider the impact to our financial statements audit. Interior will likely face hurdles with our external auditors due to the inability to dedicate more resources to the performance of more surveys. Because of resources constraints, Interior may experience adverse action during the financial statement audit once [Technical Bulletin] 2006-1 becomes effective as written."

A4. Members had an opportunity to ask representatives from DOI questions about its request at the April 28, 2011, board meeting during a separate discussion related to Technical Bulletin 2011-1, *Accounting for Federal Natural Resources Other than Oil and Gas*. At that meeting, several of the board members agreed that they would like to have a status of what other agencies were doing before they made a decision on it.

A5. In addition to obtaining more specific information on DOI's methodology and its facilities, staff performed the following research and outreach regarding reporting for asbestos-related liability costs following the April 28, 2011, FASAB meeting:

a. Researched and reviewed how other federal agencies (entities that primarily apply standards issued by the nongovernmental Financial Accounting Standards Board (FASB) and early implementers of FASAB requirements) have reported asbestos-related liability costs;

b. Researched and reviewed how respondents to FASB Interpretation No. (FIN) 47, Accounting for Conditional Asset Retirement Obligations (now FASB Accounting Standards Codification (ASC) 410-20), *Asset Retirement Obligations*, and others, have reported asbestos-related liability costs;

c. Sent a poll on agency readiness for implementation of Technical Bulletin 2006-1 to Agriculture, Commerce, Defense, Energy, General Services Administration, Health and Human Services, Homeland Security, Housing and Urban Development, DOI, Justice, Labor, National Aeronautics and Space Administration, National Science Foundation, State, Transportation, Treasury, Veterans Affairs, the Financial Statement Audit Network listserv, and participants of the Accounting and Auditing Policy Committee Asbestos Subgroup;

d. Organized an agency roundtable on implementation of Technical Bulletin 2006-1 to provide an opportunity for the federal community to:

i. learn about others' experiences and methodology for estimating asbestos cleanup costs per the requirements of:

   1. FASAB SFFAS 6, *Accounting for Property, Plant, and Equipment, Chapter 4, Cleanup Costs*; and Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*; and,

   2. FASB ASC 410-20, *Asset Retirement Obligations*

ii. discuss best practices and issues surrounding the implementation of Technical Bulletin 2006-1; and,

e. Actively sought participants that would be willing to share different methodologies and best practices related to reporting of asbestos-related liabilities at the roundtable.

A6. Based on staff's research and outreach, the majority of agencies believe they have taken the steps necessary to implement Technical Bulletin 2006-1 for fiscal year 2012. However, of the agencies responding to staff's readiness poll, the three agencies that responded that they would not be ready for a 2012 implementation data, collectively own over 60% of the total number of buildings and over 49% of the total square footage reported on the fiscal year 2009 Federal Real Property Statistics Report.[1]

A7. At the June 22, 2011, meeting, staff briefed FASAB board members on the results of its research and outreach and answered questions related to DOI's request and staff's recommendation. A representative from DOI who was observing the meeting responded to members' questions about the current status of its efforts and plans for implementation.

A8. DOI is actively working towards developing a reasonable estimate of their asbestos-related liabilities, but has formally requested a little more time to finalize it. In addition, several other agencies that collectively own over half of the federal real property are not yet prepared for a 2012 implementation. With the information shared at the June 2011 FASAB roundtable on implementation of Technical Bulletin 2006-1 and the expectation that the Chief Financial Officers (CFO) Council will lead an effort to coordinate implementation through the sharing of relevant data and experience, staff believes DOI and other federal agencies will be better positioned to more effectively implement the reporting requirements. The planned joint efforts will likely lead to more cost effective implementation as well as more comparable results. To allow time for such efforts, a fiscal year 2013 implementation date is needed.

[1] Available online at www.gsa.gov/graphics/ogp/FY2009_FRPR_Statistics.pdf; last accessed April 21, 2011.

A9. For those reasons, staff recommends that the effective date of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, be deferred for one additional year to enable DOI and other agencies to finalize their methodology and develop an estimate. Early implementation is strongly encouraged.

A10. In addition, to ensure that issues arising during the implementation effort are identified timely, staff plans to host an additional roundtable in early 2012.

Exposure Draft

A11. The exposure draft, *Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Costs*, was issued July 13, 2011, with comments requested by August 3, 2011. Upon release of the exposure draft, notices and press releases were provided to The Federal Register, *FASAB News*, *The Journal of Accountancy*, *AGA Today*, *the CPA Journal*, *Government Executive*, *the CPA Letter*, and *Government Accounting and Auditing Update*, The CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and, committees of professional associations generally commenting on exposure drafts in the past.

A12. To encourage responses, a reminder notice was provided to our Listserv on August 2, 2011.

Comment Letters

A13. Thirteen comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		1
Auditors		
Preparers and financial managers	12	

A14. The Board considered responses to the exposure draft at its August 24, 2011, meeting. Eleven of the 13 respondents were in favor of deferring the effective date. Two respondents did not comment on the proposal. Since there was no opposition to the deferral proposed in the ED, staff recommended that the proposal be issued as final.

A15. One respondent questioned whether there was a need for such a standard since there are vast differences between agencies and a “one size fits all” approach may not be the best one. The respondent suggested that FASAB consider deferring final implementation of Technical Bulletin 2006-1 until the ongoing efforts of FASAB and the CFO Council to coordinate implementation of Technical Bulletin 2006-1 are complete. Staff believes deferring until the CFO Council coordinates could further delay implementation as other priorities arise. Staff recommends issuing the one-year deferral.

A16. Another respondent commented that, in order for an environmental liability (EL) to be present, there must be an existing law or regulation that requires cleanup. The respondent stated that, since asbestos is not currently required to be cleaned up until it becomes friable, non-friable asbestos is not an EL. The respondent asked for clarification and clear guidance on how non-friable asbestos could result in an EL. Staff notes that the Basis for Conclusions (BfC) of Technical Bulletin 2006-1 includes a discussion regarding why there is an accounting liability for cleanup of non-friable asbestos even though there is no EL for cleanup of asbestos until it becomes friable. The accounting liability is based on the FIN 47 (ASC 410-20) premise that "no building lasts forever." The difference between the two liabilities is further discussed in pars. A13 and A14 from the BfC in Technical Bulletin 2006-1:

A13. As noted in paragraph 5, asbestos-related cleanup costs includes cleanup costs related to both friable and nonfriable asbestos-containing material. Under the asbestos NESHAP [National Emissions Standards for Hazardous Air Pollutants], friable asbestos is currently required by law to be removed, contained, and properly disposed of in the context of a demolition or renovation of a covered facility. There is no immediate requirement for the federal government to remove nonfriable asbestos in good condition that is not currently posing a health threat. However, the future repair, removal, renovation, demolition or other disturbance of asbestos-containing material may cause the asbestos to become friable and, because of limitation on the life of PP&E other than land, it is inevitable that these actions will occur. Thus, the event triggering the liability is the existence of asbestos in federal property, plant, and equipment, not a legal requirement to remove, contain, or dispose of the asbestos. Therefore, the accounting treatment for asbestos provided for in this technical bulletin is based on the best estimate of the costs that will be incurred in the future for removal, containment, or disposal of asbestos that exists in federal property, plant, and equipment as of the reporting date. The ability of the federal government to sell the federal property, plant, and equipment or otherwise dispose of it in the future without incurring any asbestos-related cleanup costs may affect measurement of the liability but does not negate the existence of the liability as of the reporting date.

A14. It is important to note that the requirement to estimate a liability for asbestos-related cleanup costs and the requirement to actually perform asbestos-related cleanup are two completely separate requirements. It is not within the scope or the intent of accounting standard-setters to establish what asbestos-related cleanup will be required and when. This must be determined by reference to applicable law. Furthermore, this technical bulletin does not intend to imply that recognizing a liability for asbestos-related cleanup costs in any way reflects a judgment about the legal obligation of the federal government for asbestos-related cleanup. The purpose of this technical bulletin is to provide guidance that will result in the more consistent and timely recognition of an accounting liability.

A17. Another respondent noted overall agreement with the one-year deferral but stated that the Board should adopt DOI’s request that the information be reported as RSI in addition to the one-year deferral. This suggestion cannot be adopted through a technical bulletin since it would require an amendment to an existing Statement of Federal Financial Accounting Standards.

A18. The Board has reviewed this Technical Bulletin, and a majority of its members do not object to its issuance.

Appendix B: Abbreviations

AGA	Association of Government Accountants
ASC	Accounting Standards Codification
BfC	Basis for Conclusions
CFO	Chief Financial Officers
CPA	Certified Public Accountants
DOI	U.S. Department of the Interior
EL	Environmental Liability
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FIN	FASB Interpretation Number
NESHAP	National Emissions Standards for Hazardous Air Pollutants
PP&E	Property, Plant, and Equipment
RSI	Required Supplementary Information
SFFAS	Statement of Federal Financial Accounting Standards

Technical Bulletin 2017-1: Intragovernmental Exchange Transactions

Status

Issued	November 1, 2017
Effective Date	Effective upon issuance.
Affects	This TB clarifies SFFAS 5 and SFFAS 7 regarding intragovernmental exchange transactions.
Affected by	None.

Summary

This Technical Bulletin (TB) clarifies existing standards regarding intragovernmental exchange transactions. Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, define exchange transactions and exchange revenue respectively. However, neither fully addresses the unique nature of intragovernmental transactions. This TB provides guidance to aid in determining whether intragovernmental arrangements are exchange transactions. Specifically, it addresses whether value has been sacrificed and received by the parties to a transaction. Generally, if both parties agree that value has been exchanged (that is, each asserts that value is received and sacrificed), identify the nature of the value received and sacrificed, and demonstrate exchange of something of value, then the transaction should be considered an exchange transaction. This is true even if there is a significant difference in the values exchanged or between the value received and the cost incurred to obtain the value.

This TB improves the reporting of revenue and cost information by ensuring that transactions are appropriately classified. It also reduces the barriers to and cost of adopting generally accepted accounting principles.

Materiality

The provisions of this TB 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.

Table of Contents

Technical Guidance

Scope

1. What reporting entities are affected by this Technical Bulletin (TB)?

2. This guidance applies to all reporting entities that present general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

3. What accounting practices are addressed in this TB?

4. This TB guides identification of intragovernmental exchange transactions. This TB does not address recognition and measurement of exchange transactions.

5. When one federal entity (the providing entity) arranges for a third-party to perform services for another federal entity (the receiving entity) (for example, outsourcing such as arranging for an office lease for another federal entity) and both the providing and the receiving entity sacrifice and receive value in the transaction, is the entire transaction an exchange transaction?

6. Yes, if the transaction meets the definition of an exchange transaction then the entire transaction is an exchange transaction.[1] Therefore, the providing entity should record exchange revenue for the full amount the providing entity billed to the receiving entity;[2] the receiving entity should record expense and/or a capitalized asset consistent with GAAP for the full amount payable to the providing entity. This is true even if the providing entity does not fully recover its administrative costs or plays only a minor role in the transaction. For example, the service provided may be limited to coordinating funding, facilitating transactions, negotiating contracts, and/or providing other related arrangements.

[1] As discussed in paragraph 10. if both parties agree that value has been exchanged (that is, each asserts that value is received and sacrificed), identify the nature of the value received and sacrificed, and demonstrate exchange of something of value, then the transaction should be considered an exchange transaction.

[2] The providing entity incurs the costs of providing the service such as paying contractors, employees, and other resources providers. The receiving entity then pays the providing entity.

7. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 33 defines exchange revenue as "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." The full amount billed to customers should be recognized as exchange revenue. Even when the service is limited, such as being an intermediary to third-parties, amounts received are appropriately classified as exchange revenue. The providing entity earns the full amount of the payment by ensuring that the receiving entity's criteria are met. Exchange transactions contrast with nonexchange transactions where no value is expected or received by one of the parties.

8. Further, both the providing and receiving entity should report the full cost of the transaction. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, as amended requires entities generally to recognize the full cost. Paragraph 108 adds "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." Recognizing the full cost facilitates an assessment of the performance of both entities. For example, the full cost of outsourced services is relevant to assessing how well the providing entity performed its role regarding the outsourced services. For the receiving entity, the full cost is relevant to assessing the efforts undertaken during the reporting period.

9. Is it necessary to consider whether the overall value to each party in the arrangement is approximately equal or whether the value to each party is approximately equal to the cost in determining whether the transaction is an exchange transaction?

10. No, SFFAS 7 requires only that some value is received and sacrificed by both parties to qualify as an exchange transaction. Also, SFFAS 7 acknowledges that intragovernmental arrangements are between parties under common control; such arrangements are non-market transactions.[3] For non-market transactions, the value received in return for the revenue given may not be equivalent. Generally, if both parties agree that value has been exchanged (that is, each asserts that value is received and sacrificed), identify the nature of the value received and sacrificed, and demonstrate exchange of something of value, then the transaction should be considered an exchange transaction. This is true even if there is a significant difference in the values exchanged or between the value received and the cost incurred to obtain the value. Further, whether or not the providing entity incurs net revenue or net cost as a result of the transaction does not affect the classification.

[3]SFFAS 7, par. 46(b).

11. SFFAS 7, paragraph 111 recognizes that exchange transactions may "occur between entities within the Government, sometimes as stipulated by law and in other cases by mutual agreement." Consequently, classification as an exchange transaction is not dependent on whether the transaction is stipulated by law, policy, or by mutual agreement of the parties.

12. What does "sacrifice value" mean?

13. Value may be sacrificed in many ways including by:

a. making a payment

b. providing something of value (such as an item of property)

c. performing a service (such as consulting, advising or informing another party), or

d. arranging a contract or agreement or coordinating funding on behalf of another party.[4]

14. In some cases, the value sacrificed may not be measurable. In addition, the act of sacrificing value may provide value to both parties. For example, providing a consulting service may result in knowledge of benefit to both parties to the transaction as well as to others. The inability to measure the value sacrificed and the fact that the good or service is of continuing value to the provider, and possibly to others, does not mean the transaction is not an exchange transaction. As an exchange transaction, recognition of cost (or capitalized asset) and revenue should be based on the applicable standards. That is, it is not necessary to establish the "value" exchanged in order to recognize cost and/or revenue.[5]

15. What types of value may be considered sacrificed and received for an intragovernmental transaction to be classified as an exchange transaction?

16. As noted earlier, intragovernmental transactions are between parties under common control; such arrangements are non-market transactions. If the parties agree that value has been exchanged, identify the nature of the value exchanged, and demonstrate that the exchange occurred then the transaction qualifies as an exchange transaction. Government operations are increasingly integrated; particularly where common goals require a

[4]SFFAS 4, par. 106-107.

[5]For example, SFFAS 4, par. 15 defines "cost" 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."

coordinated effort. Each party to a transaction should assess whether the transaction provides value.[6]

17. The party's classification of the transaction is particularly important because exchange transactions affect the gross and net cost of each reporting entity. If a party improperly identifies the transaction as a non-exchange transaction, the amounts would be reported on the statement of changes in net position which would misstate net cost during the reporting period. To avoid misstating net cost, a reporting entity's assertion that value was sacrificed and received when combined with identification of the nature and receipt of that value should result in classification as an exchange transaction.

18. Parties considering whether they sacrificed and received value may consider value that is:

    a. direct (such as goods or services made available to them through the actions of the other party);

    b. indirect (such as goods or services made available to support their mission as a result of the actions of the other party);

    c. tangible (such as property, plant, or equipment);

    d. intangible (such as information systems, written materials, or information);

    e. quantitative (such as a specific amount of a good or service); or

    f. qualitative (such as guidance or advice that may not be measurable).

19. The benefits of a transaction may not be exclusively for the parties to the transaction. Notwithstanding this fact, the transaction should be classified as an exchange transaction as long as the providing and receiving entities agree that they sacrifice and receive value of an identified nature as a result of the transaction.

20. Further, reimbursements for certain goods and services may be made by some but not all entities benefitting from such goods and services. The failure of some to make reimbursements does not affect the transaction between the parties.

[6]Note that this TB should be applied in determining whether a transaction is exchange or non-exchange for purposes of applying GAAP. It does not determine treatment for budgetary purposes. The budgetary term "transfer" is broad and may include transactions appropriately classified as exchange transactions for GAAP purposes. Treatment of a transaction as a budgetary transfer does not preclude its classification as an exchange transaction under GAAP. Guidance regarding classification for budgetary purposes is provided by the Office of Management and Budget.

Effective Date

21. The requirements of this TB are effective upon issuance.

The provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

The Federal Accounting Standards Advisory Board has authorized its staff to prepare Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with the Board's rules of procedure, as amended and restated through December 2003, 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.

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.

This guidance may be affected by later documents. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that affect this guidance. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

A1. In 2014, the Department of Defense (DoD) requested the Federal Accounting Standards Advisory Board's (FASAB or "the Board") consideration of a project after identifying several financial reporting areas of concern and related audit challenges. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, by providing the appropriate guidance to address issues not clearly addressed within the framework of existing accounting standards.

A2. This Technical Bulletin (TB) is proposed in response to a request for guidance related to certain intragovernmental transactions. The guidance addresses transactions among components that DoD performs throughout execution of its mission that cannot be addressed effectively without further guidance. Also, it is believed that this guidance may assist other federal entities in applying existing accounting standards to similar transactions.

A3. This TB addresses how to identify intragovernmental exchange transactions. DoD raised these questions regarding receipts resulting from Economy Act[7] orders. One question is whether to record exchange revenue for only the portion of goods/services provided to other

[7]The Economy Act (31 U.S.C. 1535) authorizes agencies to enter into agreements to obtain supplies or services from another agency.

agencies that the agency performs itself or for the total cost recovered from other agencies including the reimbursement of costs of goods/services outsourced to other Federal agencies or vendors. This guidance is not limited to Economy Act orders because GAAP applies based on the substance of a transaction rather than the form.

A4. This TB does not address recognition and measurement of exchange transactions. Existing standards adequately address the timing of recognition as well as the amount to be recognized.

Exchange Transactions

A5. SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 23 states that "an exchange transaction arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources." In the specific case DoD refers to, DoD is arranging for a lease on behalf of another entity. Administrative services provided by DoD are a small part of the overall service associated with the lease.

A6. Nonetheless, the providing entity (DoD) receives value through the payments from the receiving entity and sacrifices value through incurring the cost to acquire the good or service from the third-party for the receiving entity. The receiving entity receives value through the good or service provided by the providing entity and sacrifices value through payments to the providing entity. The full amount of the transaction qualifies as an exchange transaction.

A7. The providing entity should record the full amount billed to the receiving entity as exchange revenue and the receiving entity should record the total amount it is billed as an expense or capitalized asset consistent with GAAP. The transaction does not qualify as a transfer-in/out--a nonexchange transaction--because some value is identified by both parties as being sacrificed and received (or acquired). In contrast, per SFFAS 5, paragraph 24, "a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising value in return."

A8. The specific case presented raises the question of whether the recovery of the cost of services the providing entity "outsources to other Federal agencies and/or commercial vendors" should be reported as a transfer-in rather than as exchange revenue. Presumably, if it was appropriate to classify the recovery of the cost as a transfer-in then the corresponding cost for the outsourced services would be classified as a transfer-out to ensure that all the outsourced amounts were excluded from the Statement of Net Cost. This issue is directly addressed in SFFAS 4, paragraphs 108-109. Specifically, paragraph 108 states "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."

A9. SFFAS 4 does not make a distinction between full cost paid for administrative services versus costs paid to other federal agencies or commercial vendors. Treating the recovery of third-party amounts as transfers-in and the associated costs as transfers-out would be contrary to the guidance in SFFAS 4 intended to reveal the full costs on both the providing and receiving entities' Statements of Net Cost.

A10. SFFAS 7 does not require an assessment of the value given and received by each party in exchange transactions because the standards do not define exchanges as being of approximately equal value. In intragovernmental transactions, the providing entity may or may not provide a significant amount of value in relation to the contract. Even when the value of the administrative services is small in relation to the third-party services or the providing entity is not reimbursed or not fully reimbursed for its administrative services, the providing entity is to report the full cost of the transaction[8] and recognize exchange revenue for any amounts billed. For example, the providing entity may simply place an order under an existing contract or prepare funding documents.

A11. In fact, the parties to the transaction may not be permitted to establish fair value exchanges. When an entity provides goods and services that consist of arranging a contract, such as a lease agreement with a commercial vendor, the entity may be reimbursed for the contract cost as well as an administrative fee, for an amount less than these two cost components, or for an amount more than these two cost components. Nonetheless, the full reimbursement qualifies as exchange revenue. Therefore, the providing entity recognizes exchange revenue for the total amount billed. SFFAS 7 does not provide guidance regarding the value given or received. As noted above, intragovernmental transactions are between parties under common control; such arrangements are non-market transactions and, therefore, may present unique challenges regarding the sacrifice and receipt of value between entities under common control. This TB provides that the parties to the transaction should determine whether value was sacrificed and received, identify the nature of those values, and demonstrate the exchange occurred (see par. 16).

A12. In addition, the TB discusses unique circumstances such as exchanges of value where other parties also benefit from the transaction. For example, FASAB is funded by its sponsors in a joint effort to provide accounting standards for use by all federal reporting entities. Clearly, each sponsor believes value is provided but it would provide little value to determine whether that value equals the amount of funding for the Board and how that value might be affected by the fact that all reporting entities--including entities not providing

[8]SFFAS 4, par. 108.

funding to the Board--receive the accounting standards. Notwithstanding the delivery of accounting standards to all federal agencies, each sponsor should recognize the funding provided as a cost consistent with this being an exchange transaction. Treatment of the funding as a transfer-out, as if this was a non-exchange transaction, would misstate the cost to each party.

Summary of Outreach Efforts and Responses

A13. The exposure draft (ED), *Intragovernmental Exchange Transactions*, was issued September 5, 2017, with comments requested by September 29, 2017.

A14. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News*, the *Journal of Accountancy*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A15. 16 comment letters were received from preparers, auditors, professional associations, individuals and users of federal financial information. The Board considered responses to the exposure draft at its October 2017 meeting. Staff did not rely on the number in favor of or opposed to a given position. Staff considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A16. The majority of respondents generally agreed with the proposed guidance. Specifically, respondents believed the TB provided guidance to aid in determining whether intragovernmental arrangements were exchange transactions. One respondent neither agreed nor disagreed with the proposal. Certain respondents provided minor suggestions and editorial comments that were incorporated into the final guidance or addressed in the basis for conclusions.

A17. One respondent that disagreed stated the proposed guidance has the potential to cause a major change in accounting practice, conflicts with SFFAS 7 (Appendix B) and 4, and introduces new criteria for determining when accounting events occur. As a result, the respondent believes it would be challenging for agencies and auditors to know what transactions the technical guidance applies to versus other FASAB standards.

A18. FASAB staff considered carefully the potential that a major change in practice could result from this guidance. Based on initial research and positive feedback from 12 respondent federal departments and agencies, staff concluded that the guidance fills a void in the literature without causing a major change.

A19. FASAB staff also considered whether the guidance conflicts with SFFAS 7, Appendix B. Appendix B provides guidance for the classification of transactions including intragovernmental transactions but the guidance does not adequately address the receipt and sacrifice of value. For example, par. 315 identifies "intragovernmental sales of goods and services by a fund other than a revolving fund" as instances when "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 exchange revenue." The technical bulletin aids in determining when each party receives and sacrifices something of value. In doing so, it augments but does not conflict with SFFAS 7.

A20. Certain respondents requested that there be an explanation of how this proposed guidance would be affected by the exposure draft, *Amending Inter-entity Cost Provisions*[9] if it is approved by the Board. The proposal would amend existing standards by limiting the reporting of inter-entity costs to business-type activities. However, personnel benefits and Treasury Judgment Fund settlements are required to be imputed by GAAP standards other than SFFAS 4, and those standards ensure they continue to be imputed by all reporting entities. Further, the modifications proposed in the exposure draft include the option for future recognition of other inter-entity costs if the Office of Management and Budget decides to do so. Staff believes it is most appropriate to state the receiving entity "should record the total amount it is billed as an expense or capitalized asset consistent with GAAP" as this would be accurate going forward.[10]

A21. Certain respondents requested clarity regarding if the receiving entity is directly billed[11] by the vendor. Staff notes that that paragraph 13 explains the ways value may be sacrificed [making a payment, providing something of value, performing a service, or arranging a contract or agreement or coordinating funding on behalf of another party] and paragraph 18 explains the type of value that should be considered [direct, indirect, tangible, intangible, quantitative, and qualitative]. If no value is sacrificed, such as for amounts directly billed to and paid by the receiving entity, then the transaction would not meet the definition of an exchange transaction.

[9]*Amending Inter-entity Cost Provisions* was released for comment on September 1, 2017 with comments requested November 30, 2017.

[10]Specifically, the phrase "consistent with GAAP" would apply to reporting entities required or not required to impute costs. It would also be relevant before and after *Amending Inter-entity Cost Provisions* is deliberated by the Board, and remain true if the proposal is approved or not. At this time staff cannot state if *Amending Inter-entity Cost Provisions* will be approved by the Board.

[11]For example, the receiving entity's funds may be directly placed on a contract; therefore the providing entity does not bill the receiving entity.

Board Review

A22. The Board has reviewed this Technical Bulletin, and a majority of members do not object to its issuance.

Technical Bulletin 2017-2: Assigning Assets to Component Reporting Entities

Status

Issued	November 1, 2017
Effective Date	Effective upon issuance.
Affects	This TB clarifies SFFAS 6 regarding which component reporting entity should report an asset.
Affected by	None.

Summary

Assets may be owned by one component of a larger reporting entity, such as a department, but used and/or funded by another component of the same entity. Individual standards addressing asset recognition and related reporting do not provide detailed guidance to resolve the question of which component reporting entity should report an asset. This is especially challenging for large, complex departments, such as the Department of Defense, that have numerous components and sub-components.

This Technical Bulletin (TB) provides guidance to address areas not directly covered in existing Statements and clarifies existing standards. The TB provides that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, using the asset in its operations, or on another rational and consistent basis. There should be a process in place to ensure all assets within a reporting entity are assigned. The TB provides that assets may only be assigned by a component reporting entity to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department).

This TB facilitates reporting for large and complex organizations so that reporting is better aligned with their operations and results in less costly financial reporting by permitting the reporting entity to align reporting with established funding and governance structures. This TB also reduces the barriers to and cost of adopting generally accepted accounting principles.

Materiality

The provisions of this TB 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.

Table of Contents

Technical Guidance

Scope

1. **What reporting entities are affected by this Technical Bulletin**?

2. This guidance applies to all component reporting entities that present general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

3. **What accounting practices are addressed in this Technical Bulletin?**

4. This Technical Bulletin (TB) provides guidance regarding which component reporting entity should report an asset, the related depreciation, and deferred maintenance and repairs. This TB does not provide guidance regarding recognition of expenses related to use of an asset such as fuel for vehicles.

5. **Are there certain assets that are excluded from this guidance?**

6. Yes, the Fund Balance with Treasury is excluded from this guidance. In addition, any assets that are not assets of the reporting entity cannot be assigned by the reporting entity to its component reporting entities.

7. **How should assets be assigned to component reporting entities?**

8. Assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, using the asset in its operations, or on another rational and consistent basis. Different bases may be used for assigning different assets. A policy for assigning assets to component reporting entities should be established, documented and followed consistently. There should be a process in place to ensure all assets within a reporting entity are assigned. In addition, assets may only be assigned by a component reporting entity to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department).[1]

[1] In the year of implementation, assets assigned to another component reporting entity should be treated as transfers of assets per SFFAS 7, *Accounting for Revenue and Other Financing Sources*.

9. **Is there additional guidance as to what constitutes a reporting entity, a component reporting entity, and a sub-component reporting entity?**

10. Yes, SFFAS 47, *Reporting Entity,* provides the framework for determining what organizations (for example, component reporting entities or sub-components) should be included in the reporting entity's GPFFRs for financial accountability purposes. SFFAS 47 also provides that "component reporting entity" is used broadly to refer to a reporting entity within a *larger reporting entity.*[2] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities also include *sub-components* (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Disclosure Requirements

11. Reporting entities should describe the policies used to assign significant assets.

Effective Date

12. The requirements of this TB are effective upon issuance.

The provisions of this Technical Bulletin need not be applied to immaterial items.

[2]The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

Appendix A: Basis for Conclusions

The Federal Accounting Standards Advisory Board (FASAB or "the Board") has authorized its staff to prepare Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with the Board's rules of procedure, as amended and restated through December 2003, 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.

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.

This guidance may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this guidance. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

Department of Defense Implementation Guidance Request Project

A1. Since 2014, the Department of Defense (DoD) has requested the FASAB's consideration of several financial reporting areas of concern. While DoD continues its efforts to comply with the Chief Financial Officers Act of 1990 (as amended), it has noted certain challenges. The Board agreed to undertake this project to address an issue that was not addressed within the framework of existing accounting standards.

A2. Assets may be owned by one component of a large department but used and/or funded by another component. Individual Statements addressing asset recognition and related reporting do not provide detailed guidance to resolve the question of which component reporting entity should report an asset as well as related amounts such as deferred maintenance and repair.

A3. This is especially challenging for large, complex departments such as DoD that have numerous component reporting entities and sub-components. Many specialized components provide services to other components of DoD. There are many complex relationships among the components and sub-components of DoD. In addition, law may prohibit one component from owning assets; instead, another component owns the assets and hosts the component using the assets. In such cases, there may or may not be a financial transaction related to use of the assets.

A4. For example, this situation presents itself when one service, such as the U.S. Navy, has possession and use of a helicopter that was purchased (owned) by the U.S. Air Force. In using the helicopter, the Navy alters the state of the equipment by making major improvements that extend the useful life and increase its capabilities. If the Air Force carries the base asset, is it appropriate for the Navy to carry the improvement? Alternatively, it may be more appropriate for the Air Force to recognize the entire asset, including improvements funded by the Navy. There are numerous examples such as this regarding relationships among the components and sub-components of DoD, shared ownership of assets, improvements, and maintenance of such equipment.

A5. This Technical Bulletin (TB) is intended to provide guidance to address areas not directly covered in existing Statements. This technical guidance clarifies existing standards by providing that assets may be assigned to component reporting entities within a larger component reporting entity on a rational and consistent basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, using the asset in its operations, or on another rational and consistent basis.

A6. Reporting entities should establish and document a policy for assigning assets to component reporting entities and follow it consistently. In the year of implementation, assets assigned to another component reporting entity should be treated as transfers of assets per SFFAS 7, *Accounting for Revenue and Other Financing Sources.* Any change in such policy would be reported in accordance with SFFAS 21. There should be a process in place to ensure all assets within a reporting entity are assigned. In addition, assets may only be assigned by a component reporting entity to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department).

A7. This TB is permissive and does not require any agency to change accounting practices. The flexibility may be useful for other federal agencies with complex structures or multiple sub-components.

A8. Appendix B: Illustration offers a non-authoritative diagram that may be useful in understanding the application of this guidance.

Summary of Outreach Efforts and Responses

A9. The exposure draft (ED), *Assigning Assets to Component Entities*, was issued September 12, 2017, with comments requested by October 13, 2017.

A10. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News, the Journal of Accountancy*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A11. 12 comment letters were received from preparers, auditors, professional associations, individuals and users of federal financial information. The Board considered responses to the exposure draft at its October 2017 meeting. Staff did not rely on the number in favor of or opposed to a given position. Staff considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A12. The majority of respondents (8 out of 12) generally agreed with the proposed guidance. Specifically, respondents believed the TB provided guidance to address areas not directly covered in existing Statements and clarifies that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. One respondent neither agreed nor disagreed with the proposal. Three respondents disagreed with the proposal. Certain respondents provided minor suggestions and editorial comments that were incorporated into the final guidance or addressed in the basis for conclusions.

A13. FASAB staff considered carefully the potential that a major change in practice could result from this guidance. Based on initial research and positive feedback from 7 respondents, staff concluded that the guidance fills a void in the literature without causing a major change. Specifically, this guidance is permissive and does not require any agency to change accounting practices. It is meant to afford flexibility for federal agencies with complex structures.

A14. Two respondents that disagreed stated the proposed guidance has the potential to cause a change in accounting practice and conflicts with Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. Although concepts statements guide the Board's development of accounting and reporting standards, the GAAP hierarchy provides that statements of federal financial accounting concepts are not GAAP. Instead, concepts statements constitute "other literature" and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature.

A15. SFFAC 5, paragraphs 10 through 16 discuss at a conceptual level associating elements with an entity. Based on these concepts, an asset would be recognized by the component reporting entity having a comprehensive relationship to it. If there is no component reporting entity having a comprehensive relationship, then the asset should be reported by the component reporting entity most responsible for managing it. Currently, individual standards addressing asset recognition and related reporting do not provide detailed guidance useful to resolving the question of what entity should report the asset as well as related amounts such as deferred maintenance and repair.

A16. Staff does not agree that this TB conflicts with SFFAC 5. This TB provides guidance that would be helpful in resolving assignment of asset questions that were not readily resolved through consideration of concepts level guidance. For complex departments with many specialized sub-component reporting entities, there would be many cases for which there is no component reporting entity having a comprehensive relationship to the asset. This TB makes explicit that reporting entities should establish a policy for assigning assets. While judgment may be exercised to determine which component reporting entity is most responsible for managing such assets, this TB provides that such judgments should be systematic and rational.

A17. Two respondents that disagreed requested clarification of the use of transfers as detailed in SFFAS 7, *Accounting for Revenue and Other Financing Sources.* Staff added a footnote to clarify the difference between an asset assignment and asset transfer.

A18. The majority of respondents (9 out of 12) also agreed that reporting entities should describe the policies used to assign significant assets. One respondent neither agreed nor disagreed with the proposal. Two respondents that disagreed with the proposed disclosure requirements stating the proposed requirement would increase the amount of disclosures and related costs. Staff notes this guidance is permissive and does not require any agency to change accounting practices. It is meant to afford flexibility for federal agencies with complex structures; the disclosure requirements are for policies used to assign *significant* assets.

Board Review

A19. The Board has reviewed this Technical Bulletin, and a majority of members do not object to its issuance.

Appendix B: Illustration

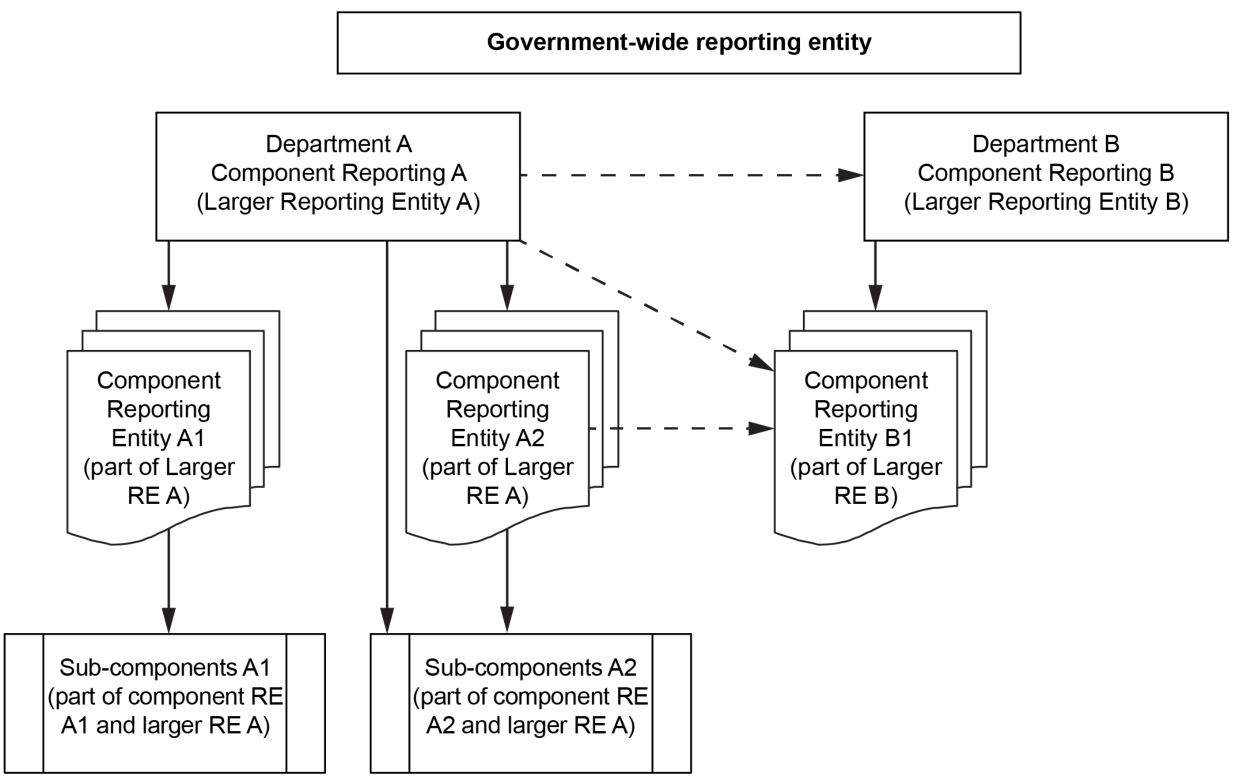
This diagram illustrates how the provisions of this Technical Bulletin could be applied to organizations. It is presented for illustrative purposes only and is nonauthoritative. It does not:

1. represent actual organizations,

2. provide a thorough analysis of all the facts and circumstances that are needed to reach a conclusion in practice,

3. indicate a preferred method of analyzing facts and circumstances, and

4. substitute for the application of professional judgment to actual facts and circumstances.



Source: GAO.

Assets may only be assigned by a component reporting entity (Department) to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department). In the illustration, this would represent assignments connected with a solid line.

Assets may not be assigned to component (or sub-component) reporting entities that are not part of the same larger reporting entity. This would prohibit assigning assets across departments. In the illustration, these are depicted with a dashed line.

Technical Bulletin 2020-1: Loss Allowance for Intragovernmental Receivables

Status

Issued	February 20, 2020
Effective Date	Effective upon issuance.
Affects	This TB clarifies SFFAS 1, paragraphs 40-52 by providing that recognition of losses applies to both intragovernmental receivables and receivables from nonfederal entities.
Affected by	None.

Summary

This Technical Bulletin (TB) clarifies existing standards regarding accounts receivable and related recognition standards and reporting. Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, establishes the definition, recognition, measurement, and disclosure requirements for accounts receivable. SFFAS 1 provides for two types of receivables: receivables from federal entities, or intragovernmental receivables, and receivables from nonfederal entities. It requires separate reporting of the two types of receivables.

This TB clarifies SFFAS 1 by establishing that even though SFFAS 1 identifies the two types of receivables, the absence of explicit guidance distinguishing between the accounting of intragovernmental receivables and receivables from nonfederal entities does not mean the standards only apply to receivables from nonfederal entities. This TB also clarifies that recognition of losses, provided in paragraphs 40-52 of SFFAS 1, applies to both intragovernmental receivables and receivables from nonfederal entities.

The TB also clarifies SFFAS 1 by explaining the allowance approach is not a "write-off" of a receivable. Rather, it is a method for reporting an amount that the entity believes is realizable by requiring only accounts receivable, net of an allowance, to be reported on the financial statements. An allowance recognized in a reporting entity's financial statements does not alter the underlying statutory authority to collect the receivable or the legal obligation of the other intragovernmental entity to pay.

This TB facilitates consistent reporting of accounts receivable in accordance with generally accepted accounting principles.

Materiality

The provisions of this TB 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.

Table of Contents

Technical Guidance

Scope

1. What reporting entities are affected by this Technical Bulletin (TB)?

2. This guidance applies to all reporting entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

3. What accounting practices are addressed in this TB?

4. This TB clarifies standards regarding accounts receivable and related recognition standards and reporting.

5. Does the absence of explicit guidance distinguishing between the accounting of intragovernmental receivables and receivables from nonfederal entities in the accounts receivable standards in SFFAS 1, *Accounting for Selected Assets and Liabilities*, mean the standards only apply to receivables from nonfederal entities?

6. No, the absence of explicit guidance distinguishing between (or not specifically referring to both) the accounting for intragovernmental receivables and receivables from nonfederal entities in the accounts receivable standards does not mean that the standards only apply to receivables from nonfederal entities.

7. Paragraph 40 of SFFAS 1 states, "The accounting standard for accounts receivable is set forth below." The standards provided in SFFAS 1 continue to refer to "accounts receivable" as such.

8. SFFAS 1 acknowledges that there are two types of receivables and provides for separate reporting in paragraph 42 as follows: "***Separate reporting.*** Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities." Similarly, SFFAS 1 distinguishes between entity and non-entity receivables.

9. However, in making this distinction in paragraph 42, SFFAS 1 does not imply that the accounts receivable standards will distinguish between intragovernmental receivables and

receivables from nonfederal entities for other areas, such as recognition of loss allowances or disclosures. Instead, SFFAS 1 consistently refers to "receivables" or "accounts receivable" when discussing both types of receivable, just as it addresses recognition of receivables prior to identifying the two types of receivables for separate reporting in paragraph 42. The Federal Accounting Standards Advisory Board (FASAB or "the Board) made the distinction only when discussing the separate reporting. Therefore, other than where indicated, references to "receivables" and "accounts receivable" incorporate both intragovernmental receivables and receivables from nonfederal entities.

10. Does the guidance regarding recognition of losses provided in paragraphs 40-52 of SFFAS 1 apply to both intragovernmental receivables and receivables from nonfederal entities?

11. Yes, guidance regarding recognition of losses provided in paragraphs 40-52 of SFFAS 1 applies to both intragovernmental receivables and receivables from nonfederal entities. As discussed in the previous question, the absence of explicit guidance distinguishing between the accounting for intragovernmental receivables and receivables from nonfederal entities in the accounts receivable standards of SFFAS 1 does not mean the standards only apply to receivables from nonfederal entities.

12. The accounts receivable standards in SFFAS 1 primarily refer to "receivables" and do not distinguish between specific types, with the exception of paragraph 42, which provides for separate reporting. SFFAS 1 details the recognition of receivables, the recognition of loss allowances, and disclosure by referring to "receivables" and not distinguishing between intragovernmental receivables and receivables from nonfederal entities. Paragraph 42 is the only paragraph that distinguishes between intragovernmental receivables and receivables from nonfederal entities by providing for the separate reporting of them.

13. Is there additional guidance regarding recognition of losses for intragovernmental receivables that should be considered, especially when a statute or law requires that the receivable be reimbursed?

14. Where appropriate, the allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value (that is, allowance approach). It is important to consider that the standard is to assess whether amounts recognized are realizable and that the allowance approach does not necessarily result in a "write-off" of a receivable. Instead, it is an adjustment needed to estimate the receivable to its net realizable value for reporting purposes.

15. In paragraph 131 of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, the Board acknowledges in

the basis for conclusions that an allowance for intragovernmental receivables may be appropriate, but may not always be needed:

16. The factors and criteria that are considered regarding intragovernmental receivables and recognition of losses should be documented in the reporting entity's departmental policy.

17. As explained, SFFAS 1 requires only accounts receivable, net of an allowance, to be reported on the financial statements. It does not require the write-off of a receivable. Further, recognizing an allowance on a reporting entity's financial statements does not alter the underlying statutory authority to collect the receivable or legal obligation of the other intragovernmental entity to pay. For example, intragovernmental receivables may represent payments that are required by statute, but this statutory requirement does not, in itself, eliminate the need of reporting an allowance for financial statement presentation.

18. Reporting entities are encouraged to disclose information that would provide transparency and explain intragovernmental receivables, such as what the receivables represent and efforts made to collect them.

Effective Date

19. The requirements of this TB are effective upon issuance.

The provisions of this Technical Bulletin need not be applied to immaterial items.

Appendix A: Basis for Conclusions

The Federal Accounting Standards Advisory Board (FASAB or "the Board") has authorized its staff to prepare Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with the Board's rules of procedure, as amended and restated through October 2010, 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.

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.

This guidance may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this guidance. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

Department of the Treasury Request

A1. The Department of the Treasury (Treasury) raised a concern regarding the recognition of losses against intragovernmental receivables (for example, receivables stemming from transactions among federal entities). Treasury did not believe it was appropriate for a reporting entity to recognize a loss allowance for intragovernmental receivables, particularly in cases where the balances are required by statute to be repaid.

A2. Treasury provided the example that it makes judgment claim payments on behalf of many federal reporting entities. Although reporting entities are required, in many cases by statute, to reimburse Treasury for some payments, many of these reimbursements are not made in a timely manner-raising questions about collectability.

A3. SFFAS 1 indicates that losses should be recognized when it is more likely than not that some or all of the balance will not be collected. Treasury requested FASAB to review SFFAS 1 and provide clarifying guidance, noting the language in SFFAS 1 is vague. Specifically, Treasury believed SFFAS 1, paragraph 44 was not clear as to its application to intragovernmental receivables, implying that there could be a delineation in the application of allowance for doubtful accounts intragovernmental receivables from nonfederal entities.

A4. Specifically, Treasury interpreted the absence of explicit guidance to mean FASAB has no specific view on intragovernmental receivables or did not intend to include it in the guidance for recognition of losses. Treasury further interpreted the absence of explicit guidance to mean that the accounting for and reporting of losses on intragovernmental receivables should be predicated on the inherent nature of those receivables-occurring between and among components of a single, legal entity and, in some cases, subject to statutory requirements. Consequently, Treasury issued a policy memo and the Bureau of the Fiscal Service made system changes to preclude agencies from reporting an allowance for losses of intragovernmental receivables to ensure consistent treatment government-wide.

A5. However, some auditors raised concerns that Treasury's proposed policy (and system change) was inconsistent with GAAP. Therefore, certain agencies, based on concerns raised by auditors, could not conclude that there was adequate justification to change the accounting policy as suggested by Treasury.

A6. As a result, Treasury requested FASAB to review this issue. At a minimum, Treasury believed that the intent of SFFAS 1, with respect to the accounting for and reporting of losses on intragovernmental receivables, was unclear. The Board agreed that guidance would resolve any uncertainty regarding SFFAS 1.

Current Standards

A7. SFFAS 1 provides the accounting standards for accounts receivable and related recognition and reporting standards in paragraphs 40-52 as follows:

Accounts Receivable

40. Accounts receivable arise from claims to cash or other assets. The accounting standard for accounts receivable is set forth below.

41. ***Recognition of receivables.*** A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date, (e.g., taxes not received by the date they are due), or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made. [See SFFAS 7, paragraph 53 for more.]

42. ***Separate reporting.*** Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities.

43. ***Entity vs. Non-entity receivables***. Receivables should be distinguished between ***entity receivables*** and non-entity receivables. Entity receivables are amounts that a federal

entity claims for payment from other federal or nonfederal entities and that the federal entity is authorized by law to include in its obligational authority or to offset its expenditures and liabilities upon collection. ***Non-entity receivables*** are amounts that the entity collects on behalf of the U.S. government or other entities, and the entity is not authorized to spend. Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity.

44. ***Recognition of losses due to uncollectible amounts.*** Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase more likely than not means more than a 50 percent chance of loss occurrence.

45. An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value. The allowance for uncollectible amounts should be reestimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct.

46. ***Measurement of losses.*** Losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole.

47. **Individual account analysis.** Accounts that represent significant amounts should be individually analyzed to determine the loss allowance. Loss estimation for individual accounts should be based on (a) the debtor's ability to pay, (b) the debtor's payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

48. The allowance for losses generally cannot be based solely on the results of individual account analysis. In many cases, information may not be available to make a reliable assessment of losses on an individual account basis or the nature of the receivables may not lend itself to individual account analysis. In these cases, potential losses should be assessed on a group basis.

49. ***Group analysis.*** To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics.

50. The groups should reflect the operating environment. For example, accounts receivable can be grouped by: (a) debtor category (business firms, state and local governments, and individuals), (b) reasons that gave rise to the receivables (tax delinquencies, erroneous benefit payments, trade accounts based on goods and services sold, and transfers of defaulted loans to accounts receivable), or (c) geographic regions (foreign countries, and domestic regions). Within a group, receivables are further stratified by risk characteristics.

Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables.

51. Statistical estimation by modeling or sampling is one appropriate method for estimating losses on groups of receivables. Statistical estimation should take into consideration factors that are essential for estimating the level of losses, including historical loss experience, recent economic events, current and forecast economic conditions, and inherent risks.

52. **Disclosure.** Agencies should disclose the major categories of receivables by amount and type, the methodology used to estimate the allowance for uncollectible amounts, and the total allowance.

A8. The previous Board was consistent in the accounts receivable standards language in SFFAS 1. SFFAS 1 consistently refers to "receivables" or "accounts receivable" because the asset being discussed is Accounts Receivable. Therefore, these terms are used when discussing recognition of receivables, recognition of loss allowances, and disclosures.

A9. The only time the distinction is made between intragovernmental receivables and receivables from nonfederal entities is in paragraph 42 of SFFAS 1, which is specific to the separate reporting of receivables. Therefore, there is no indication that a distinction would be made in other circumstances.

Other Factors Considered

A10. While FASAB staff understand Treasury's position, staff concluded that this position does not justify recommending that the Board revise current standards. Current standards require the allowance approach and that is not a "write-off" of a receivable. Instead, it is an adjustment needed to estimate the amount that is realizable. The factors and criteria that are considered regarding intragovernmental receivables and recognition of loss allowances may be complex.

A11. An allowance in a reporting entity's financial statements does not alter the underlying statutory authority to collect the receivable or legal obligation of the other intragovernmental entity to pay. For example, intragovernmental receivables may represent payments that are required by statute. However, the statutory requirement for payment of intragovernmental receivables does not, in itself, eliminate the need for an accounts receivable allowance for financial statement presentation, and the recognition of an allowance does not eliminate the need for the payment or collection of the receivable.

A12. Therefore, it is important that a reporting entity policy regarding allowances and criteria for assessing collectability be documented. Reporting entities should consult with appropriate government-wide offices to ensure proper monitoring, follow-up, and other practices are followed to the fullest extent practicable and comply with government-wide efforts to ensure timely payment and collection of intragovernmental receivables.

A13. Reporting entities are encouraged to disclose information that would provide transparency and explain intragovernmental receivables, as appropriate. For example, in an effort to demonstrate accountability, reporting entities may choose to disclose information about their efforts to collect, secure funding to settle legally enforceable claims, and resolve disputes, if applicable. Reporting entities may also disclose material receivable amounts by reporting entity, an aging of receivables, and a narrative explanation regarding the allowances, if appropriate, including the reason for the allowances (for example disputed amounts or stated intent to not pay).

Summary of Outreach Efforts and Responses

A14. The exposure draft (ED), *Loss Allowance for Intragovernmental Receivables*, was issued August 30, 2019, with comments requested by October 1, 2019.

A15. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, the FASAB newsletter, the Journal of Accountancy, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A16. Fourteen comment letters were received from preparers, auditors, professional associations, and users of federal financial information. The Board considered responses to the ED at its October 2019 meeting. Staff did not rely on the number in favor of or opposed to a given position. Staff considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A17. Respondents generally agreed with the proposed guidance. Specifically, respondents generally believed the TB clarifies guidance covered in existing Statements. The respondents generally agreed that the absence of explicit guidance distinguishing between the accounting of intragovernmental receivables and receivables from nonfederal entities in SFFAS 1 does not mean the standards only apply to receivables from nonfederal entities.

A18. Respondents also generally agreed that the TB clarifies that recognition of losses provided in paragraphs 40-52 of SFFAS 1 applies to both intragovernmental receivables and receivables from nonfederal entities. In addition, it clarifies that an allowance recognized in a reporting entity's financial statements does not alter the underlying statutory authority to collect the receivable or legal obligation of the other intragovernmental entity to pay.

A19. Although certain respondents agreed with the guidance, some expressed concern about the unresolved intragovernmental eliminations issue. There is much complexity regarding intragovernmental receivables and payables between federal entities. Further, the issues the federal government faces when there are differences prevents proper elimination during the preparation of the consolidated financial statements. Specific guidance regarding the elimination process and the related communications between federal agencies regarding the receivable/payable process should come from central federal agencies (Treasury and the Office of Management and Budget) and not contradict FASAB standards. The TB encourages reporting entities to disclose information that would provide transparency and explain intragovernmental receivables.

A20. Two respondents that noted agreement with the proposals suggested the guidance should provide examples of when a loss for an intragovernmental receivable should be recognized. Similarly, one respondent that disagreed stated that a loss allowance should not apply to a particular type of transaction. Developing and documenting criteria for evaluating collectability of intragovernmental receivables is more appropriate by management in departmental policy or guidance. In addition, there is an element of judgment regarding collectability of receivables and this cannot be prescribed or included in specific examples. The guidance in the TB does not mandate an allowance for doubtful accounts for any particular account to be recorded; it requires that an assessment be made.

Board Review

A21. The Board has reviewed this Technical Bulletin, and a majority of members do not object to its issuance.

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin

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
Affects	None.
Affected by	None.
Related Guidance	Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*

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.

Table Of Contents

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

The provisions of this Technical Release need not be applied to immaterial items.

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
Affects	None.
Affected by	• 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.

Table Of Contents

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. 6[1] 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.

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[1]The 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 operations.[2]

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.

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,

[2]In 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.

[3]This 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."

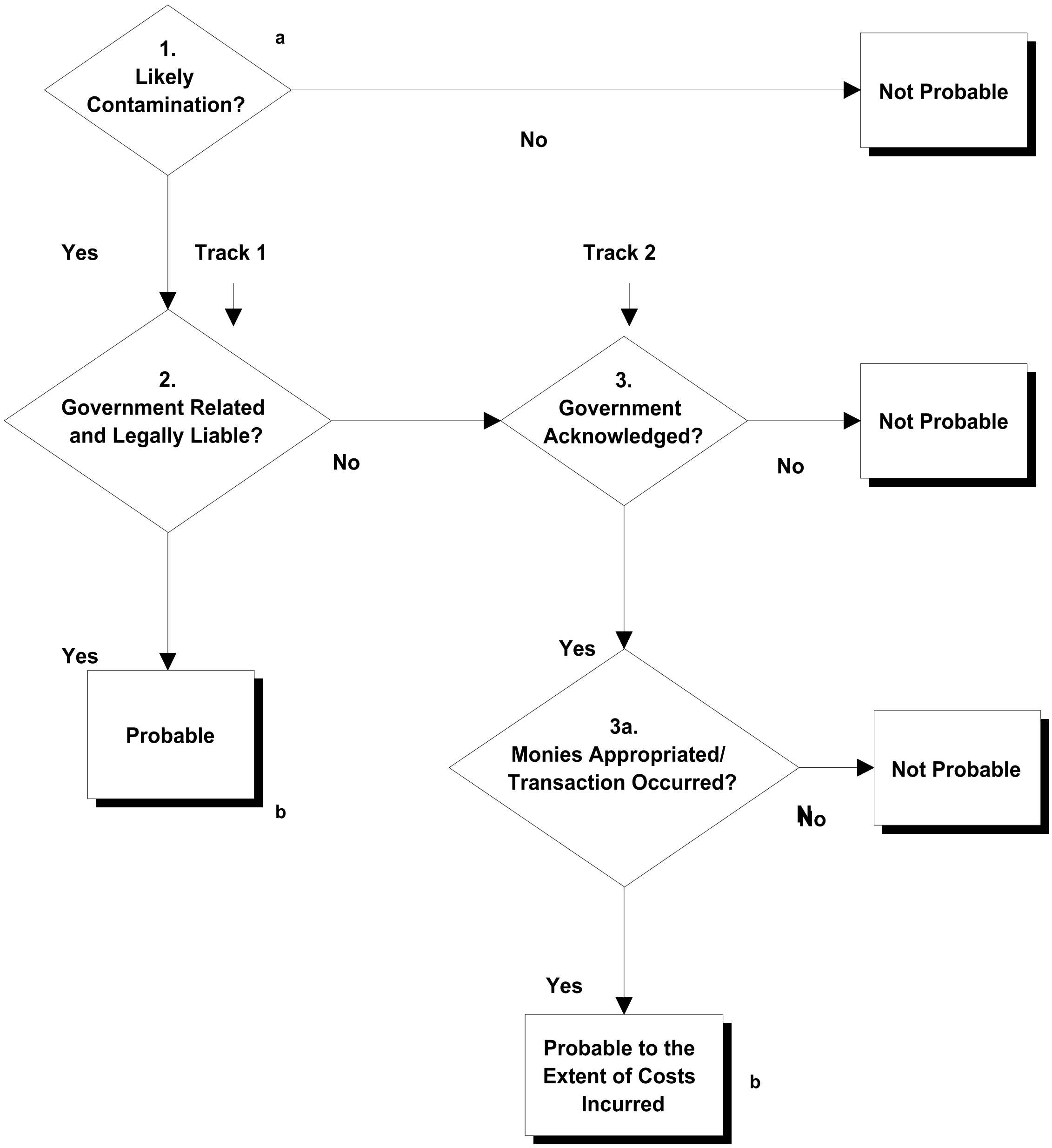
[4]This Release uses SFFAS No. 5's definition of "probable," which is "more-likely-than-not" (see par. 33 of SFFAS No. 5). This Release applies the contingent liability criteria (i.e., probable, reasonably possible, and remote) from SFFAS No. 5 to all environmental liability estimates, whether or not they meet the criteria (see par. 36 of SFFAS No. 5). [See SFFAS 12 regarding the definition of probable.]

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 Liable**[5]. 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 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

[5]Legally 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.]

[6]Federal 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.

[8]This 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).

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.

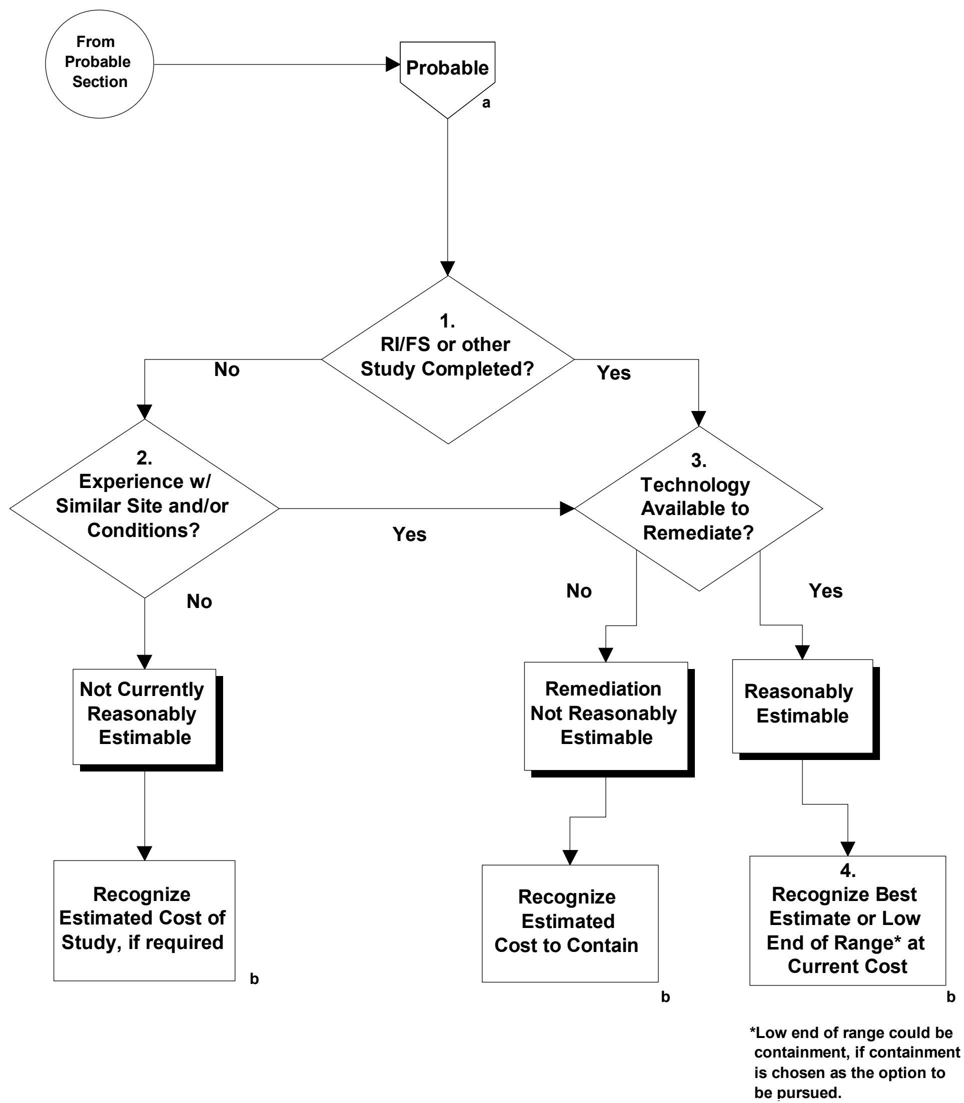
These tests for reasonably estimable are applied after a transaction or event has occurred that meets the definition of “probable” as discussed in Section 1; tests apply to both active and closed sites. The analysis should consider all significant sites, with the information rolled up into an entitywide estimate. Cost estimates should be based on current technology. Diagram 2.1 on

[9]Disclosure 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.

[10]A 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).

page 10 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.

Diagram 2.1: Determination and Quantification of Reasonably Estimable Environmental Liabilities



[a] Probable refers to track 1 (government related) which is found in Section 1. Track 2 (government acknowledged) is not applicable.

[b] With all tracks, see SFFAS #6 PAR. 107-111 and SFFAS #5 par. 40-42 for disclosure requirements.

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

[11]RCRA (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.

[12]This 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).

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

(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.

[13]AICPA Statement of Position (SOP) 96-1, *Environmental Remediation Liabilities*, page 43 par. 6.2.

[14]If 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.

The following shows how environmental cleanup costs[15] for active sites should be recognized for general and stewardship PP&E under SFFAS No. 6.

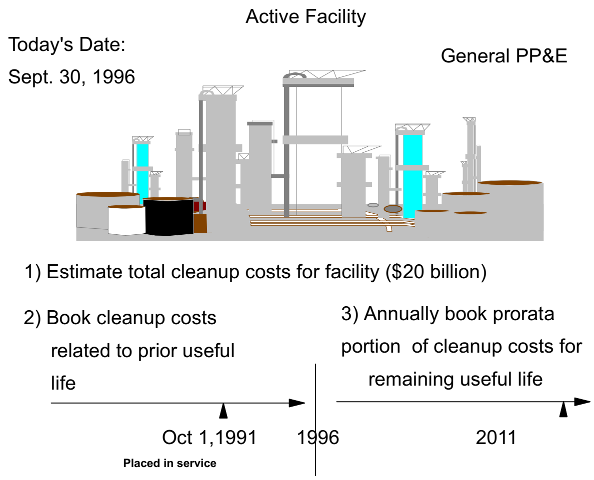
General PP&E

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 cleanup)[16] 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.

[15]Costs 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.

[16]Current cost should be based on existing laws, technology and management plans (SFFAS No. 6, paragraph 188).



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 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 years' 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]

[17]SFFAS No. 6 paragraph 104

For general PP&E placed in service after the effective date of the standard, the agency should estimate the total cleanup costs[18] 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 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.

The provisions of this Technical Release need not be applied to immaterial items.

[18]According 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.

[19]The 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
   A. As applicable

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
Affects	None.
Affected by	Technical Releases 3-Revised and 6 rescinded Technical Release 3 in its entirety.

Technical Releases 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* and Technical Release 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act-- *Amendments to Technical Release No.3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* rescinded 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 22, 2004
Effective Date	Immediately
Affects	Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*
Affected by	None.
Related Guidance	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*

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.

Table of Contents

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.

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.

Understanding the Credit Subsidy Estimate Process

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]

[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.

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 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,

[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.

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.

Identifying Material and High Risk Credit Programs for Internal Control and Substantive Testing

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 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 risks[3] 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 than isolated incidents and the auditor should be careful to distinguish between the two.

[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.

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.

30. Internal control is a process--affected by an agency's management[5] 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.

[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.

[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.

Assessing the Control Environment

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 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 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

[6] A copy of the model is available from OMB's Budget Analysis Branch.

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.

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.

Information and Communication

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 identifiers[7] used in the spreadsheets are appropriate and consistent with the description of the identifier contained in the applicable user's guide of the 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

[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.

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]

[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."

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.

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 testing[9] 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

[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.

material cohorts for testing to obtain sufficient coverage of the balance being audited or doing a 100 percent sample.

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.

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:

[10] Codification of Statements on Auditing Standards, AU Section 342, Auditing Accounting Estimates.

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 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

[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.

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 calculated[12] 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.
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

[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.

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. Scan[13] 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

[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.

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 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.

The provisions of this Technical Release need not be applied to immaterial items.

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,

[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.

- 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.
    - 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 pre-1992 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	*Frequency:* 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.	*Frequency:* 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.
	Timing: At the end of the fiscal year.	*Timing*: Typically as of the end of the fiscal year.
Technical Reestimate	*Frequency:* 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.	*Frequency:* Any year when material. Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.
	Timing: At the end of the fiscal year unless otherwise approved by OMB.	*Timing:* 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 Requirements[15]

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	Credit Reform Information Presented
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.	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
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.	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
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.	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.
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.

Table Of Contents

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 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

[1] The 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.

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.

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.

[2]This is generally because the central fund does not take custody of nonvalued items.

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.

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.

The provisions of this Technical Release need not be applied to immaterial items.

[3]Other 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.”

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
Affects	None.
Affected by	Technical Release 16 rescinded Technical Release 5 in its entirety.

Technical Release 16, *Implementation Guidance for Internal Use Software* rescinded Technical Release 5 in its entirety.

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 22, 2004
Effective Date	Immediately
Affects	Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*
Affected by	None.
Related Guidance	Technical Release No. 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*

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.

Table of Contents

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.

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]

[1] SFFAS No. 2, paragraph 17. Also see SFFAS No. 2 paragraph 66.

[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.

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 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.

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 control[4] 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

[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).

[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.

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 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:

    - 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.

[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.

- 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 calibration[6] within the model(s). Also, document the

[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.

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 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

[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.

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. 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 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).

[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."

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.

[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.

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 assumption[10] 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).

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]

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[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.

[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.

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 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.

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.

[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.

[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	Frequency: 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.	Frequency: 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.
	Timing: At the end of the fiscal year.	Timing: Typically as of the end of the fiscal year.
Technical Reestimate	Frequency: 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.	Frequency: Any year when material. Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.
	Timing: At the end of the fiscal year unless otherwise approved by OMB.	Timing: 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.

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 change has occurred that would materially affect the financial statements,

[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.

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. <u>If an acceptable monitoring process is not in place, reestimates must be made annually for the financial statements.</u> 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 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 reestimate[16] 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,

[15] See footnote 12 for a discussion of the "balances approach" for calculating reestimates.

[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.

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 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]

[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.

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]."

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.

The provisions of this Technical Release need not be applied to immaterial items.

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 pre-1992 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
B3aii Fiscal year 1992 unsubsidized loan to farmer B

Appendix B: Summary of Selected Reporting Requirements[19]

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	Credit Reform Information Presented
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.	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
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.	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
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.	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 7: Clarification of Standards Relating to the National Aeronautics and Space Administration's Space Exploration Equipment

Status

Issued	May 25, 2007
Effective Date	Immediately
Affects	None.
Affected by	None.

Summary

The purpose of this technical release is to provide technical guidance to the National Aeronautics and Space Administration (NASA) regarding the accounting treatment of NASA's space exploration equipment for financial reporting purposes. At issue is whether it is permissible to treat the acquisition or development costs of any of this equipment as research and development costs. The objective of this technical release is to provide guidance to NASA on the application of the current FASAB standards.

Table of Contents

Abbreviations

AAPC	Accounting and Auditing Policy Committee
AICPA	American Institute of Certified Public Accountants
CFO	Chief Financial Officer
DoD	Department of Defense
FAS	Financial Accounting Standard
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
NASA	National Aeronautics and Space Administration
ND	National Defense
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
R&D	Research & Development
RTD&E	Research, Testing, Development, and Evaluation
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SIG	Staff Implementation Guidance
TR	Technical Release

Introduction

Purpose

1. The purpose of this technical release is to provide technical guidance to the National Aeronautics and Space Administration (NASA) regarding the accounting treatment of NASA's space exploration equipment for financial reporting purposes. At issue is whether it is permissible to treat the acquisition or development costs of any of this equipment as research and development costs. Three specific questions were posed to the AAPC by NASA in reference to the issue. The objective of this technical release is to provide guidance to NASA on the application of the current FASAB standards.

Scope

2. This technical release guidance is limited to transactions involving NASA's space exploration equipment. However, the guidance related to the application of the Generally Accepted Accounting Principles (GAAP) hierarchy applies broadly to all federal entities.

3. Readers of this technical release should first refer to the hierarchy of accounting standards in Statement on Auditing Standards (SAS) 91, Federal GAAP (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.

Effective Date

4. This technical release is effective immediately.

Background

Overview

5. On July 12, 2006, NASA wrote to the AAPC requesting guidance for the accounting treatment of the National Aeronautics and Space Administration (NASA) space exploration equipment. With a series of changes to the accounting standards governing space exploration equipment, including the reclassification of Federal Mission Property in SFFAS 23 *Eliminating the Category National Defense Property, Plant, and Equipment*, NASA found existing guidance unclear regarding the accounting classification of space exploration equipment. This resulted in inconsistent and sometimes contradictory opinions from NASA's auditors.

6. In the letter to the AAPC, NASA posed three questions that it deemed central to resolving the ambiguity in the existing Federal Accounting Standards Advisory Board (FASAB) standards. These questions are as follows:

    1. Does the hierarchy of accounting principles for federal entities permit NASA to apply the SFAS 2, in determining whether space exploration equipment should be expensed as a period expense?

    2. Can space exploration equipment that does not meet the criteria for General Property, Plant & Equipment (PP&E) as defined in the FASAB Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant and Equipment*, be treated as a period expense?

    3. Does SFFAS 6 currently limit all items previously categorized as "space exploration equipment" to General PP&E?

7. The AAPC formed a task force to address NASA's questions and agreed to provide a Technical Release to guide NASA in the implementation of the standards.

Related Accounting Literature

8. In its original form, SFFAS 6 defined Federal Mission PP&E to include "space exploration equipment" and required that it be expensed. Subsequently, SFFAS 11 amended SFFAS 6, changing the classification of "space exploration equipment" to General PP&E and required

that it be capitalized. Most recently, in May 2003, SFFAS 23 rescinded SFFAS 11 and modified SFFAS 6. The related accounting literature are as follows:

Federal Accounting Standards Advisory Board Accounting Standards:

a. SFFAS 6, *Accounting for Property, Plant, and Equipment*

b. SFFAS 8, *Supplementary Stewardship Reporting*

c. SFFAS 11, *Amendments to Accounting for Property, Plant, and Equipment*

d. SFFAS 23, *Eliminating the Category National Defense Property, Plant and Equipment*

e. Staff Implementation Guidance (SIG) 23.1, Guidance for Implementation of SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*

Financial Accounting Standards Board Accounting Standards:

f. SFAC 6, *Elements of Financial Statements*

g. SFAS 2, *Accounting for Research and Development Costs*

Technical Guidance

9. This guidance is presented as responses to the three questions posed by NASA to the AAPC, with questions two and three combined.

10. Does the hierarchy of accounting principles for federal entities permit NASA to apply the SFAS 2, *Accounting for Research and Development Costs*, in determining whether space exploration equipment should be expensed as a period expense?

11. Yes. The American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards Number 91, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*, (integrated into AICPA Professional Standards, AU 411.15) provides that “in the absence of a pronouncement covered by rule 203 or another source of established accounting principles, the auditor of financial statements of a federal government entity may consider other accounting literature, depending on its relevance in the circumstances.” Other accounting literature includes the FASB Statements of Financial Accounting Standards and Interpretations.

12. SFFAS 8 addresses accounting for Research and Development Costs. SFFAS 8 provides that “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 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.” SFFAS 8, however, does not define “expenses” in the context of calculating the net cost of research and development programs. Nor do other FASAB standards specifically address recognition of research and development costs or the elements of costs that would be identified with research and development activities. However, SFFAS 23 acknowledges that the Board considered concerns about the treatment of the costs of research, testing, development, and evaluation (RTD&E) for the Department of Defense but decided that issues related to these costs can and should be addressed in the context of existing basic principles and practices. Thus, preparers have in turn looked to other authoritative literature for guidance.

13. SFAS 2 describes activities that typically would be included in and the elements of costs to be identified with research and development. Other federal agencies have turned to SFAS 2 for needed authoritative guidance. Specifically, SFAS 2 provides that the costs of materials, equipment or facilities acquired or constructed for a particular research and development project and that have no alternative future uses are treated as research and development costs in the period.

14. While SFFAS 8 is the principal authoritative source on accounting for research and development costs by federal agencies, this standard may be supplemented in order to address some of the differing research and development efforts by federal agencies. Accordingly, consistent with the provisions of AU 411.15, federal agencies may consider the provisions of SFFAS 8 together with the provisions of SFAS 2 in making a determination about accounting for research and development costs.

15. Can space exploration equipment that does not meet the criteria for General PP&E as defined in the SFFAS 6 be treated as a period expense? Does SFFAS 6 currently limit all items previously categorized as "space exploration property" as General PP&E?

16. The criteria for determining whether an item is capitalized as PP&E are outlined in SFFAS 6, paragraph 17. The typical characteristics of general PP&E are outlined in SFFAS 6, paragraph 23.

17. In its original form, SFFAS 6 defined Federal Mission PP&E to include "space exploration equipment" and required that it be expensed. Subsequently, SFFAS 11 amended SFFAS 6 to redefine "Federal Mission PP&E" as "National Defense Property, Plant and Equipment." SFFAS 11 also included explanatory language which specified that space exploration equipment was to be accounted for as general PP&E. Most recently, in May 2003, SFFAS 23 rescinded SFFAS 11 in its entirety and modified SFFAS 6 to require that National Defense Property, Plant and Equipment be capitalized as General Property, Plant, and Equipment. We realize that these changes could have caused some preparers and auditors uncertainty regarding how to apply the resulting guidance in accounting for "space exploration equipment;" however, the hierarchy of accounting literature provides a means to access literature to be relied on in determining an appropriate treatment.

18. SIG 23.1, issued to clarify the intent of the FASAB in its issuance of SFFAS 23, stated that, "assets being recognized due to the implementation of SFFAS 23 should be characterized in accordance with the asset definitions in SFFAS 6 *and other accounting standards."* The genesis of the guidance was the narrow reading of the provision of SFFAS 23, which stated that …"The amendments in this Statement… Classify all assets previously considered to be National Defense Property, Plant, and Equipment as general PP&E and the provisions for general PP&E … contained in SFFAS 6, as amended, are to be applied." The essence of the guidance was to point out that the FASAB's intent was to have preparers follow existing standards in the classification of assets. It was not the FASAB's intent to require that preparers follow SFFAS 6 without regard to the nature of the underlying asset. Accordingly, the concept discussed in SIG 23.1 should be applied, i.e., the definitions included in the accounting standards may be used to determine the classification and treatment of "space exploration equipment" and not limited to the category of General PP&E, but be categorized in accordance with the definitions of SFFAS 6 and other accounting standards.

19. The FASAB standards in and of themselves do not preclude the expensing of space exploration equipment; as stated, the characteristics of the transactions or events should govern accounting treatment.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

A1. NASA's request for guidance is based their need for clarification on the specific accounting guidance on the classification of space exploration equipment. The need for clarification is based on the many changes in the standards related to property, plant, and equipment. In 1995, SFFAS 6 originally defined space exploration equipment as Federal Mission PP&E. In 1998, FASAB classified space exploration equipment as PP&E in SFFAS 11 and also replaced the definition of Federal Mission Property with National Defense (ND) PP&E. In 2003, SFFAS 23 rescinded SFFAS 11 in its entirety and reclassified ND PP&E as General PP&E. In addition to eliminating the category ND PP&E, this rescission purged the term "space exploration equipment"[1] from the authoritative literature.

A2. In 2004, the Department of Defense (DoD) questioned whether the FASAB actually intended to require that all items falling under the ND PP&E definition in SFFAS 23 be classified as General PP&E. DoD submitted a discussion paper in July 2004 to the FASAB staff. As a result, SIG 23.1 was released. Under this guidance, ND PP&E was not limited to the category of General PP&E. SIG 23.1 states that "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… any items not properly classified as General PP&E should be valued in a manner consistent with definitions in existing standards to determine the relevant asset class."

A3. The Committee believes that NASA, in making determinations about the accounting treatment of transactions and events, should use its judgment in applying the standard that most appropriately reflects the characteristics of the transactions or events. One purpose of the hierarchy established in the AICPA Statement on Auditing Standards 91 is to permit other accounting literature to be considered in the absence of specific guidance in the FASAB standards. If it is determined that "space exploration equipment" meets the criteria for capitalization and has predominant characteristics of property, plant and equipment, then the accounting requirements in SFFAS 6 should be applied; however if the costs incurred for space exploration equipment are more similar to the R&D activities specified in SFFAS 8 and SFAS 2, then NASA should apply these standards to its space exploration equipment. The FASAB standards in and of themselves do not preclude the expensing of space exploration equipment; as stated, the characteristics of the transactions or events should govern accounting treatment. NASA's current accounting policy is to classify all theme assets as General PP&E and capitalize them. If it is determined that NASA should change

[1] "Space exploration equipment" included items intended to operate above the atmosphere for space exploration purposes, and any specially designed equipment to aid, service, or operate other equipment engaged in the exploration of space. (See SFFAS 6, par. 52.)

its current accounting policy, it should document that the accounting policy selected is preferable and the reasons therefore.

A4. One comment letter was received from the following source:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others	0	1
Auditors	0	0
Preparers and financial managers	0	0

The one respondent agreed with the guidance as it was written and added the following comments. “The hierarchy of accounting standards provides for the use of FASB standards in this case. SFAS 2 also covers the subject in sufficient detail to enable NASA to apply it to its research and development costs.”

Technical Release 8: Clarification of Standards Relating to Inter-Entity Costs (Rescinded)

Status

Issued	February 20, 2008
Effective Date	Immediately
Affects	None.
Affected by	TR 19 rescinded TR8 in its entirety.

Summary

TR 19, Recission of Technical Release 8 rescinded TR 8 in its entirety.

Technical Release 9: Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land

Status

Issued	February 20, 2008
Effective Date	Immediately
Affects	None.
Affected by	SFFAS 42.

Summary

This technical release is intended to assist federal entities in reporting information on heritage assets (HA) and stewardship land (SL) in accordance with new federal accounting standards. Federal entities are required to report descriptive, non-financial information on HA/SL as basic information in their financial reports, in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 29, *Heritage Assets and Stewardship Land*.

Table of Contents

Acronyms

AAPC	Accounting and Auditing Policy Committee
AICPA	American Institute of Certified Public Accountants
AGA	Association of Government Accountants
AT	Codification of Statements on Standards for Attestation Engagements
AU	Codification of Statements on Auditing Standards
CFR	Consolidated Financial Report of the U.S. Government
CFO	Chief Financial Officer
CPA	Certified Public Accountant
ED	FASAB published the exposure draft
FAM	U.S. Government Accountability Office Financial Audit Manual
FASB	Financial Accounting Standards Board
FASAB	Federal Accounting Standards Advisory Board
FMFIA	Federal Managers Financial Integrity Act
GAO	U.S. Government Accountability Office
GASB	Governmental Accounting Standards Board
JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget
OIG	Office of Inspector General
PP&E	Property, Plant and Equipment
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SNC	Statement of Net Cost
HA	Heritage Assets
SL	Stewardship Land

Introduction

Purpose

1. This technical release is intended to assist federal entities in reporting information on heritage assets (HA) and stewardship land (SL) in accordance with new federal accounting standards. This technical release supplements relevant federal accounting standards, but is not a substitute for and does not take precedence over the accounting standards issued by FASAB.

2. Federal entities are required to report descriptive, non-financial information on HA/SL as basic information in their financial reports, in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 29, *Heritage Assets and Stewardship Land*.

3. Prior to issuing SFFAS 29, information on HA/SL was reported as Required Supplementary Stewardship Information (RSSI). SFFAS 29 reclassifies all HA/SL information as basic financial information, except for condition information, which is reclassified as Required Supplementary Information (RSI) and may be reported with deferred maintenance information. The standard also requires that entities reference a note on the balance sheet that discloses information about HA/SL, but no asset dollar amount should be shown. Instead, the minimum reporting requirements for note disclosure include a description of major categories, physical unit information for the end of the reporting period, physical units added and withdrawn during the period, and a description of the methods of acquisition and withdrawal.

4. SFFAS 29 also requires two new disclosures for HA/SL: entity stewardship policies and an explanation of how HA/SL relate to the mission of the entity. The standard also includes the requirements for the Consolidated Financial Report of the U.S. Government (CFR). The CFR provides for a general discussion and directs users to the applicable entities' financial statements for more detailed information on HA/SL. This technical release focuses specifically on HA/SL. It does not address other types of Property, Plant, and Equipment (PP&E).

5. This technical release is organized into four sections:

   - Section I *Materiality Considerations* describes an approach for considering materiality that is common to entities as they apply the materiality concept to HA/SL. It includes qualitative factors to consider in making materiality judgments about HA/SL.
   - Section II *Identification, Categorization, and Quantification* discusses issues related to identifying HA/SL and describes how the standard allows entities "flexibility" in

determining the format and level of detail to report relevant and reliable information in note disclosures. It also explores factors affecting the level of detail such as management's selection of categories for reporting and choice of physical units within categories, as portrayed in various examples. In addition, a discussion of supporting documentation is included.

- Section III *Assessing and Reporting Condition* discusses approaches for meeting condition reporting requirements for HA/SL. This section provides guidance for identifying criteria to assess condition, discusses sources of information to support reporting, and provides examples of reporting condition.
- Section IV *Government-Wide Reporting* discusses the balance sheet note reference and a note disclosure of HA/SL information in the U.S. Government-wide financial statement.

Scope

6. 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.

Effective Date

7. The effective date for implementation of the Technical Release is for periods beginning after September 30, 2008. Earlier implementation is encouraged.

> The provisions of this Technical Release need not be applied to immaterial items.

Background

8. FASAB determined that information on HA and SL (except for condition) should be basic financial information because (1) information on these assets is essential to fair presentation and understanding of the entity's financial condition; (2) accountability for HA/SL requires more audit scrutiny than would be afforded if these assets were addressed through RSI; and (3) this classification is consistent with existing standards issued by the Governmental

Accounting Standards Board (GASB) for reporting on art and historical treasures, and Financial Accounting Standards Board (FASB) for reporting on collections, other works of art, and historical treasures.[1] Reporting condition of HA/SL as RSI is appropriate because the information is experimental in nature and the manner of assessing and reporting this information is inconsistent.[2]

Transition from RSSI to Basic/RSI Information

9. The reclassification from RSSI to basic financial information for HA/SL is being phased in as required by SFFAS 29. **The phase-in approach requires full implementation of SFFAS 29 for reporting periods beginning after September 30, 2008.** Items a and b are new note disclosures and are to be reported as basic financial information beginning in periods after September 30, 2005; items c through f temporarily move to RSI in periods after September 30, 2005 before being reported as basic financial information.

   a. A statement explaining how HA/SL relate to the mission of the entity

   b. A description of the entity's stewardship policies

   c. A description of major categories

   d. Physical unit information for the end of the reporting period

   e. Physical units added and withdrawn during the year

   f. A description of the methods of acquisition and withdrawal

10. Effective dates for transitioning the above HA/SL information **from RSI** to basic financial information (i.e., a note disclosure to the financial statements) begin for periods:[3]

   - After September 30, 2007 for items c and d,
   - After September 30, 2008 for items e and f.

[1] SFFAS 29, par. 54.

[2] SFFAS 29, par. 57.

[3] See SFFAS 29 for details on the phase-in of disclosure requirements being reported as basic information.

Section I. Materiality Considerations

11. In the interest of meaningful and cost effective information, managers of HA/SL information need to understand and apply the concept of materiality in order to decide what is material and what is not. Key issues are (1) what is the appropriate level of detail and aggregation for reporting HA/SL information and (2) how should materiality be applied to assets that are not reported in dollar amounts?

12. In developing the entity's disclosures, management should identify meaningful levels of aggregation by determining whether assets are material enough to warrant classification in separate categories. Regardless of the level of detail or aggregation, the entity should support its financial statements with internal accounting policies listing the chosen criteria and methods of aggregation and classification.

13. Materiality has both quantitative and qualitative characteristics. Traditional materiality judgments about financial information are primarily quantitative and are focused on dollar amounts. However, the fact that HA/SL are not reported in dollars requires special attention to qualitative factors such as the nature of the related assets and the circumstances in which the materiality judgment is made.

14. Management's consideration of materiality is a matter of professional judgment and is influenced by (1) the information necessary to demonstrate accountability for HA/SL, (2) the needs of a reasonable person who will rely on the principal financial statements, and (3) cost-benefit justifications. This approach incorporates two fundamental values of federal financial reporting: accountability and decision usefulness.

Accountability and Decision Usefulness

15. As the standard-setting body for the federal government, FASAB stated that there are two fundamental values that provide the foundation for governmental accounting and financial reporting: "accountability" and its corollary, "decision usefulness."[4] FASAB explained that "Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability."

[4] Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting,* par. 71.

16. Under an "accountability concept" of materiality, management uses its professional judgment to decide, on behalf of users, what information is needed to demonstrate accountability over HA/SL in accordance with federal accounting concepts and standards. Materiality is then evaluated in relation to the information considered necessary for accountability. In essence, the accountability concept of materiality considers the information needed to answer such questions as, are the assets important to the entity's mission or to the Nation? Are the assets highly visible, vulnerable, or controversial? And, is the government effectively managing and safeguarding assets?[5]

17. Traditional definitions of materiality for financial information center on "decision usefulness," a concept that relates to the needs of a reasonable person who relies on reported information to make decisions. The focus on decision usefulness originated from the primary objective of financial reporting for business enterprises established by FASB: "Financial reporting should provide information that is useful to present and potential investors and creditors and other users making rational investment, credit, and similar decisions."[6]

18. However, in the federal government, the HA/SL information that users need in order to make informed decisions is evolving since agencies are still in the early stages of reporting. Users' needs will likely become more clearly identified as the required disclosures are made available and attract users who rely on it for making decisions.[7] In the meantime, attempting to make materiality determinations about HA/SL information based solely on undetermined user needs (i.e., decision usefulness) is an uncertain approach. Therefore, for HA/SL, the current focus for considering materiality should be based on accountability. Citizens want assurances that the HA/SL entrusted to the government are protected and used for the purposes intended.[8] Congress, executives, and program managers need to demonstrate to those to whom they are accountable that they have, in fact, protected those resources and used them well.

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[5] SFFAC 1, par. 105 states, "The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. …Providing this information to the public, the news media, and elected officials is an essential part of accountability in government."

[6] Source: FASB's Statement of Financial Concepts No. 1: *Objectives of Financial Reporting by Business Enterprises,* par. 34.

[7] See SFFAC 1, par. 75-87; SFFAC 4, par. 6-9; and SFFAS 6, Basis for Conclusions, par. 123 for a summary of the users of federal financial reports and their stewardship information needs.

[8] "Citizens" include individual citizens as well as citizen intermediaries (i.e., the general news media and more specialized users such as trade journals); public interest and advocacy groups; state and local legislators and executives; and analysts from corporations, academe, and elsewhere. According to SFFAC 1, par. 76 and SFFAC 4 par. 7, "Citizen intermediaries devote more time to reading, analyzing and interpreting more detailed information that they analyze, summarize and pass on to Citizens for further application." (SFFAC 4, par. 16)

Measurement Issues

19. For the federal government HA/SL, there is no unifying theme upon which to base quantitative measures of materiality, such as, total assets or total expenses because there is no common unit of measure, such as dollars, that can be used to evaluate the effect of omissions and misstatements among HA/SL categories. In other words, HA/SL management's focus is on whether in the aggregate the categories reported for HA/SL are a complete presentation of HA/SL for which the entity is accountable. For example, management might report quantities for five separate and dissimilar categories of HA such as 6,000 linear feet of archival documents, 4,000 cubic feet of archeological artifacts, 2,500 paleontological items, 1,000 pieces of artwork, and 500 geological specimens. These diverse categories have different measurement attributes that are not readily quantifiable in monetary units.

20. Therefore, each entity should identify and apply the qualitative factors that will govern their HA/SL note disclosure. Choosing qualitative materiality factors is a practical means to achieve straightforward and consistent reporting procedures for stewardship assets. The intent is that management should do what is reasonable to report information about the entity's HA/SL yet avoid costly and burdensome reporting of unnecessary detail.

Qualitative Factors to Consider

21. Reporting information about HA/SL should reflect the entity's stewardship processes and responsibilities for managing stewardship assets. Such reporting can be accomplished, in part, by analyzing the entity's mission as part of determining which asset categories are material and warrant separate classification and presentation. As mentioned previously, factors to be considered, among others, are whether the asset categories are viewed as "important to the nation" or to the mission of the entity, and whether the assets are "visible, vulnerable, or controversial." Other factors to consider include whether the entity has significant operations, programs or activities related to the management of the HA/SL. Additionally, consideration should be given to whether HA/SL have characteristics or qualities that have widespread public interest.

Financial Presentation, Disclosure and Meaningful Aggregation

22. Inherent in preparing financial statements in conformity with GAAP, management makes financial reporting assertions about HA/SL, generally in five broad categories: existence, completeness, rights and obligations, valuation, and presentation and disclosure. As stated in the Basis for Conclusions section of SFFAS 29, "... 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 HA, how it manages and materiality considerations." [9]

23. As supported by the Basis for Conclusions for SFFAS 29,[10] management must differentiate between (a) detailed records that may be needed for management control and safeguarding purposes, and (b) presentations that are material for stewardship note disclosures. Entities may track individual assets and asset categories for control purposes that do not warrant separate presentation in their stewardship note disclosures. For example, under the Real Property Initiative of the President's Management Agenda, agencies are required to record information about assets in the *Federal Real Property Profile* database. This information is viewed as an asset manager's tool and may provide estimates on a large scale to generally depict the government's assets.

24. Management's consideration of materiality should focus on identifying *meaningful levels of aggregation* for reporting; i.e., determining which HA/SL warrant classification and presentation in separate categories. For example, are the assets unique, especially important and of exceptional interest?

25. In order to meet the reporting objectives of SFFAS 29, consistent with the financial reporting assertions, and with a focus on meaningful aggregation, management should analyze the entity's HA/SL:

    - For significant HA/SL that are considered meaningful for aggregation, establish separate categories and disclose the number of physical units[11] in each category.
    - If immaterial "entities may omit heritage asset and SL information."[12]

26. In summary, the agency is in the best position to determine the appropriate level of fair presentation, aggregation and physical units of measure for presenting each major category based on the entity's mission, the types of HA/SL, and how it manages its assets. Such determinations are highly subjective and require the use of professional judgment.

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[9] SFFAS 29, Basis for Conclusions, par. 79.

[10] SFFAS 29, Basis for Conclusions, par. 85.

[11] "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." (SFFAS 29, footnote 10).

[12] SFFAS 29, Basis for Conclusions, par. 101.

Section II. Identification, Categorization, and Quantification

27. SFFAS 29 provides considerable latitude on identifying, categorizing, and quantifying footnote information on HA/SL. The Board provides broad guidance, and allows flexibility for each entity to determine what constitutes relevant and reliable information for its individual HA/SL.[13] Reporting requirements for HA/SL include acquisitions, withdrawals, and ending balances expressed in physical units. SL physical units are by major categories of use[14] whereas HA physical units are by major category.[15] HA/SL (1) should be reported with a note reference on the balance sheet with no asset dollar amount shown and (2) costs associated with HA/SL must be recognized in the statement of net cost (SNC) for the period in which the costs are incurred. Also non-financial information on HA/SL (including multi-use HA) must be reported in the note disclosure.

28. Multi-use HA requires additional descriptive information in the heritage asset note disclosure, with cross references directing the reader from the balance sheet to the note disclosure. Multi-use HA are to be reported in both the principal financial statements (in dollars) as general PP&E and in the heritage asset note disclosure (in physical units).[16] This reporting and note disclosure would not be considered duplicative as each category is considered unique for this reporting purpose.

29. Additionally, agencies should document the identification, categorization, and quantification reasoning in their internal accounting policies and procedures to ensure the consistent reporting for all similar HA/SL.

Identification

General Issues

30. A primary issue in implementing SFFAS 29 is determining whether land is SL or General PP&E land; and whether an asset is a heritage asset, a multi-use heritage asset, or General

[13] SFFAS 29, par. 79 – 85.

[14] SFFAS 29, par. 40 d.

[15] SFFAS 29, par. 25 d.

[16] SFFAS 29, par. 27 and 29.

PP&E. Making each determination correctly is fundamental to accounting and reporting for HA/SL.

31. SFFAS 29 broadly characterizes HA/SL as generally expected to be preserved indefinitely. In addition to the definitions of HA/SL contained in the standard, HA/SL are significant to the nation's history and culture. Being listed on the National Register of Historic Places, although not considered a required criterion for identifying HA,[17] may indicate that the asset is HA. Other ways to identify HA/SL include specific designations set forth by authoritative bodies such as Congress, the President, or an agency head as well as cultural protection laws, regulations, or other cultural asset protection standards. Also, HA/SL may have characteristics or qualities that are of widespread public interest.

32. Once HA/SL have been identified, each entity must determine the most appropriate level to report these assets for purposes of the required note disclosure. This reporting depends on the types of HA/SL, the entity's mission, materiality considerations, and the entity's ability to classify such assets consistently from year to year.

33. The following HA, multi-use HA, and SL examples illustrate how some PP&E could be identified as HA or SL. However, the examples are for illustrative purposes only and their disclosures are not mandatory. The examples are not all-encompassing and agencies may identify other more useful and relevant criteria to identify HA/SL. Appendix C provides examples of footnote disclosures.

Heritage Assets

Heritage Asset Examples

34. Example 1: Historic and prehistoric structures may be identified as HA because historic structures are significant to the nation and are associated with the important people and history of the nation.[18] They are constructed works consciously created to serve some human activity or purpose. These structures include buildings, monuments, dams, canals, stockades, fences, defensive works, temple mounds, kivas, ruins of all structural types, and outdoor sculptures.

[17] SFFAS 29, par. 15 and 16.

[18] An example of such a site is the U.S. DOE Nevada Test Site on which various archeological sites have been identified. Most were left by the ancestors of the present-day Indian tribes, Paiutes and Shoshones. These sites include rock shelters, brush houses, fire pits for cooking, and artifacts on ground surfaces.

35. Example 2: National historic landmarks possess exceptional value or quality in illustrating or interpreting the heritage of the United States in history, architecture, archeology, technology, and culture. They possess a superior location, design, setting, materials, and workmanship. They are districts, sites, buildings, structures, or objects of national significance possessing exceptional value in commemorating or illustrating the history of the United States. The Historic Sites Act of 1935 authorizes the Secretary of the Interior to grant this designation as the federal government's official recognition of the national importance of historic properties.

36. Example 3: A cultural landscape is identified as a HA because of its natural and cultural significance. A cultural landscape is a geographic area, including both natural and cultural resources, associated with an historic event, activity, or person. These landscapes may contain trails, trees, waterways, or structures but are combined into one unit by their designation and collectively viewed as one HA. There are four general types of cultural landscapes: historic sites, historic designed landscapes, historic vernacular landscapes, and ethnographic landscapes.[19]

37. Example 4: Museum or library collections may be identified as HA because they may have historical significance and/or cultural, educational or artistic importance. These collections comprise objects or materials that have been gathered and maintained for exhibition or use. These items could include exhibit pieces, artifacts, published materials, and/or other literary content in any format.

[19] One example of a cultural landscape is Fort Bragg. This cultural landscape is unique because of its continued use for defense related purposes and the influences to the landscape that result from defense related activities.

Another example that encompasses three overlapping cultural landscapes is the Department of Energy (DOE) Hanford site. The first landscape represents a rich archeological and ethnographic landscape that has existed for more than 10,000 years where local American Indian tribes still revere the area for its spiritual and cultural importance, as they continue the traditions practiced by their ancestors.

The second landscape embodies the experiences of the immigrants who started arriving in the mid-19th century. Following the explorers and fur traders who passed through the area were miners, ranchers, and then farmers. In 1943, the U.S. Government acquired the land for a secret wartime project and approximately 1,500 families were forced to move. Today, the former residents and their families recall the homes they had to leave and see the remains of their farms and towns as symbols of the sacrifice they made to the war effort.

The third landscape is associated with World War II and the subsequent Cold War. The government acquired the land in 1943 to build large industrial facilities to produce plutonium, which served a vital role in the nation's defense. Hanford's mission expanded during the Cold War era to include research and development activities associated with the peaceful uses of atomic energy. Today, the remains of the facilities and legacy wastes document an important part of the nuclear age story.

Multi-use Heritage Assets

38. A HA that serves two purposes, for example, a heritage function and a government operations function, should be considered a multi-use HA and classified as general PP&E if the predominant use (not the incidental use) of the asset is in general government operations.[20] Entities should consider the predominant use of a HA in determining the appropriate accounting treatment.

Multi-use Heritage Asset Examples

39. Example 1: Assets in the Nation's capital that are currently identified as multi-use heritage assets include the Department of the Treasury and the Government Accountability Office (GAO) buildings. The main Treasury Building is used predominately for agency operations but also has historical significance as evidenced by its National Historic Landmark status. The GAO building qualifies as a multi-use heritage asset because it is listed in the National Register of Historic Places, and it is being used in general government operations.

40. Example 2: The Hoover Dam's predominant use is an operational dam providing hydro power, recreation, and water supply. It is also a National Historic Landmark and a museum facility. Therefore, it is considered a multi-use heritage asset.

41. Example 3: A Supervisor's Office for a National Forest is identified as a multi-use heritage asset because it provides administrative office space for Forest Service personnel who manage operations of the forest. While its predominant use is for administrative office space, the office is also listed on the National Register of Historic Places because of its age and unique log architectural design.

42. Examples 4 and 5 below describe assets that are not multi-use heritage assets because they do not meet the definition of HA or are exempt from classification as multi-use HA.

43. Example 4: The Punta Gorda Lighthouse is an operational lighthouse that is capitalized and reflected on the balance sheet. Even though the lighthouse is a contributing property to an historic site and has attributes that are considered historically valuable, these attributes are common to many other historic structures in the country. Management has determined that the lighthouse is not a multi-use heritage asset, because according to the managing agency's internally documented procedures for identifying heritage assets, the lighthouse does not meet the necessary level of historic significance for disclosure.

[20] SFFAS 29, par. 18.

44. Example 5: The Jefferson National Expansion Memorial (St. Louis, MO) has incidental administrative offices and shop space located in the memorial. In this case, the memorial should be reported as a heritage asset.

Stewardship Land

45. Entities commonly classify land by using a two-step process. First by determining whether the land meets the criteria for general PP&E land or SL. Land is considered general PP&E if it is "acquired for or in connection with items of general PP&E."[21] SL is land and land rights owned by the federal government but not acquired for or in connection with items of general PP&E.[22]

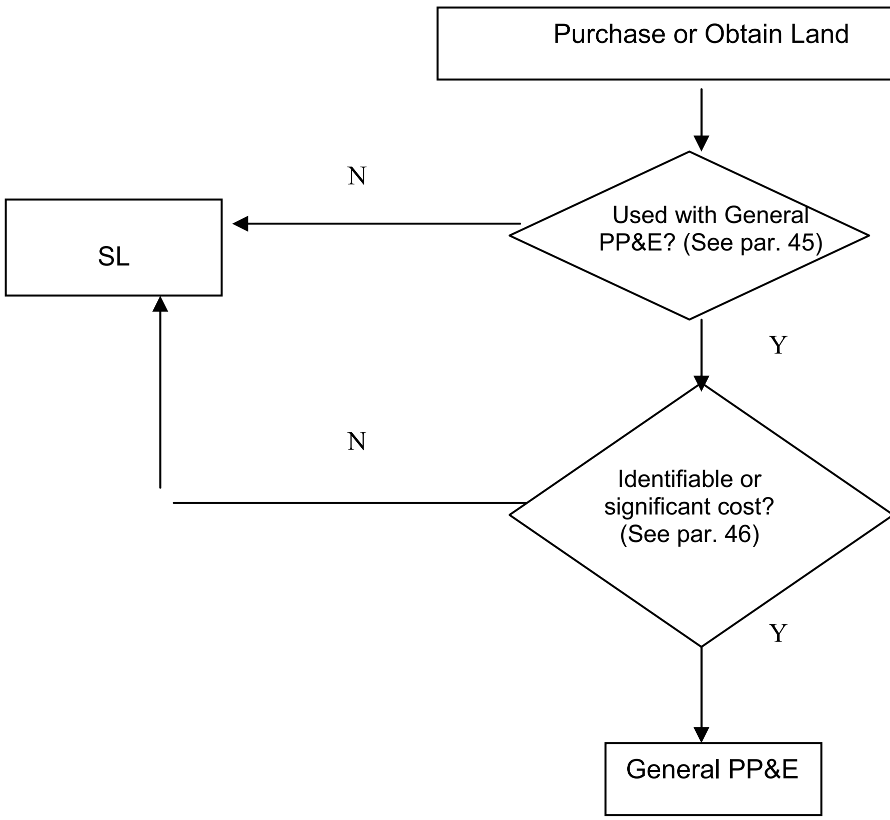
46. If land meets the criteria for general PP&E, then determine if the land has an identifiable cost.[23] If land does not have an identifiable cost or where cost is nominal or insignificant, it is SL, regardless of whether it is "acquired for or in connection with other general PP&E." The following chart provides implementing guidance for interpreting par. 25 of SFFAS 6 and par. 35 and 36 of SFFAS 29.

[21] SFFAS 6, par. 25. The phrase "acquired for or in connection with" is defined as including "land acquired with the intent to construct general PP&E and the 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," according to SFFAS 29, footnote 16.

[22] SFFAS 29, par. 33 and 36.

[23] Examples where land would have an unidentifiable, nominal, or insignificant cost would include federally owned lands that were part of the Louisiana Purchase in 1803 (Louisiana, Arkansas, Oklahoma, Missouri, Iowa, Kansas, Nebraska, South Dakota, Montana, and parts of Minnesota, Wyoming, and Colorado), the Gadsden Purchase in 1853 (parts of Arizona and New Mexico), and the Oregon Territory where American title was established in 1846 by the Spanish-American Compromise (Washington, Oregon, and part of Idaho). These lands do not have an identifiable cost because the land was acquired at nominal cost (in current dollar value) or at no cost at all. These lands are part of the originally constituted America's "public domain" land. Much of this land is no longer under federal ownership. What remains under federal ownership today is generally referred to as the "public lands."

The concept of "identifiable cost" in determining whether land is stewardship land does not apply to situations where land logically would have an identifiable cost but that cost is unknown due to inadequate accounting, weak or no internal controls, or other imprudent actions.



Stewardship Land Examples

47. Example 1: In order to establish a military base, testing ground, or firing range, an agency receives a transfer[24] of federal land that was originally part of large territories of "public domain" land that the Nation acquired at nominal cost. This public domain land, acquired by transfer from another federal entity, does not have an identifiable cost. Therefore, this public domain land is SL, regardless of how the agency uses it. In this case, the land would be categorized and reported as SL for financial reporting purposes.

48. Conversely, if land were purchased for or in connection with construction of a military base, testing ground, or firing range, it would have an identifiable cost and should be included in general PP&E. In this case, the land would be reported on the balance sheet with a dollar value along with other capital assets.

[24] See SFFAS 29, par. 39 and 40.d. (3) for the discussion on SL transfers.

49. Example 2: Agency 1 has been granted specific legislative authority to sell tracts of land that were originally public domain land (currently classified as SL) to the public and to retain a portion of the proceeds[25] from those sales to purchase environmentally sensitive tracts of land from the public in locations prescribed by the enabling legislation. The purchased land may be retained and managed by Agency 1 or it may be transferred to another federal agency (Agency 2) for management of the SL (e.g., for use as wildlife habitat, forest production, or other SL use). At the point when the sale and purchase transactions occur, the cost/value of the land sold and purchased is known. However, this SL is not associated with general PP&E and therefore is classified as SL.

50. In this example, Agency 1 would report a reduction in the quantity of SL reflecting the disposal (sale) transaction. When land is subsequently purchased, Agency 1 would show an increase in the quantity of SL reflecting the purchase transaction. If the purchased land is transferred to Agency 2, Agency 1 would show a reduction in the quantity of SL reflecting the transfer to Agency 2 for management. Agency 2 would reflect an increase in its quantity of SL. No monetary amounts relating to land would be reported on the balance sheet.

51. When each agency develops its footnote disclosures, the actual increase or decrease in categories and/or physical units depends on how each agency in the example chooses to categorize and quantify its SL. In this example, Agency 1 has a "multiple-use" category[26] and quantifies its land by management unit. As such, if a management unit were reduced or increased in size but not eliminated or created, there would be no net change in its reporting. Agency 2 has a major category of use of conserving, protecting, and enhancing fish and wildlife and their habitats. Agency 2 quantifies its land by refuge. If the increase in land does not create a new refuge, then Agency 2 would also show no net change in its reporting.

52. Example 3: An agency purchases land for $300,000 that is to be added to a wildlife refuge for wildlife habitat. In this example, the land has an identifiable cost, but it was not acquired for or in connection with general PP&E. Therefore, it does not qualify as general PP&E land. Thus, the land is SL and the $300,000 purchase price would be expensed in the year of acquisition.[27] In this example, if the reporting unit (wildlife refuge) was increased in size, but the increase did not create a new refuge, then the entity would show no net change in its

[25] Generally speaking, federal agencies can sell and purchase land. However, without specific legislative authority, they cannot retain proceeds from the sales of land for any agency purpose. Proceeds from the sale of land would normally be transferred to the General Fund of the Treasury.

[26] An example of "multiple-use" land is when legislation requires the use of multiple natural resources (i.e., domestic livestock grazing, fish and wildlife development, mineral exploration and production, rights-of-way, outdoor recreation, and timber production) related to the SL and no single use is predominant.

[27] In accordance with SFFAS 29, par. 37.

reporting related to SL units. However, if the agency reports by units, such as acreage, it would reflect an increase in units.

Categorization

53. SFFAS 29 emphasizes reporting on asset categories, rather than individual assets[28] such that reporting should be by major category for HA and major category of use for SL.[29] Moreover, entities should determine the appropriate level of detail for their categorization. Related groups of assets that do not warrant classification and presentation in separate categories should be aggregated.[30]

General Issues

Designation of Categories

54. The determination of which HA/SL warrant presentation in separate categories is related to whether they are material based on management's judgment. As described in the section on *Materiality Considerations*, management's consideration of materiality for HA/SL focuses on meaningful levels of aggregation for the stewardship note disclosures.

Establishing the Level of Reporting Detail

55. The appropriate information for reporting HA/SL can vary from one entity to another, as well as from a component entity to the consolidated entity. The level of detail of the information presented depends, in part, on the mission of the entity, the types of stewardship assets, how the entity manages the assets, and the materiality of the assets in question.[31] For example, an agency with stewardship as its primary mission might choose to report more extensive and detailed categories than an agency that does not have a stewardship

[28] SFFAS 29, par. 25.c. and 40.c.

[29] The phrase "major category of land use" is not specifically defined in SFFAS 29. However, based on the definition of land (the solid part of the surface of the earth), one might reasonably assume that the land functions as the foundation for natural resources and as a basin for water resources (water being a natural resource). It is the natural resources that land-management agencies manage, and it is the resources for which they authorize use. Hence, the phrase "major category of land use" can be implied to mean "major category of resource use."

[30] Aggregation of assets into categories could be compared to or likened to identifying "major classes" of assets. SFFAS 6 provides examples of major classes for general PP&E in footnote 63. These include, among others, buildings and structures, furniture and fixtures, equipment, vehicles, and land.

[31] See Section on *Materiality Considerations.*

mission. It is important to clarify that agencies may establish levels of detail for HA/SL and manage them for control purposes in a manner that is different from how they categorize and aggregate them for financial reporting purposes.

56. Also, some HA/SL categories overlap because they are defined in ways that result in certain assets, such as landscape monuments, being reported as both HA and SL. However, such reporting is not duplicative because the type of information reported for each category is different. For example, while a landscape monument might count as one item in the category of HA, the land supporting the monument could be included in the physical units under SL.[32] The *Craters of the Moon National Monument and Preserve* might be reported as HA and the vast expanse of land under the monument reported with the many tracts of land managed by the district.

Heritage Assets

57. SFFAS 29[33] requires that entities categorize HA by "major category." Major categories can be defined in many ways such as:

- The characteristics or attributes that make them unique, e.g., historical, natural, cultural, educational, artistic, or architectural;
- Designations of significance by experts or government leaders;
- The nature of the items such as collectible or non-collectible;
- Structural or non-structural; and
- Asset use such as transportation, dwellings, shipping, ghost towns, military, farming, burial, and many others.

58. Some examples of categories of HA, which are not intended to be all encompassing, include:

- Monuments,
- Landmarks,
- Landscapes,
- National Parks,
- Museums,
- Cemeteries,
- Libraries, and
- Districts or Regions.

[32] In accordance with SFFAS 29, par. 17.

[33] Par. 25 item c.

Heritage Asset Examples

59. Example 1: Pompeys Pillar is categorized as a national landmark that is both HA and SL. This landmark is a rock outcropping, a massive natural block of sandstone and a major landmark along the route of the Lewis and Clark Expedition. Because of its historical significance, (including Clark's signature carved on its surface), it is included in the National Historic Landmarks Program and therefore considered an HA. The National Park Service categorizes Pompeys Pillar as a National Historic Landmark property type of "landscape – natural feature." The managing agency has determined the physical unit to be the number of landmarks in this category.

60. Example 2: Some national monuments are included in HA categories because of their historic or natural attributes and because sometimes they contain aspects of both. An example is the Grand Staircase-Escalante National Monument,[34] which has primarily landscape attributes. This monument's vast and austere landscape embraces a spectacular array of scientific and historic resources. This high, rugged, and remote region, where bold plateaus and multi-hued cliffs run for distances that defy human perspective, was the last place in the continental United States to be mapped. Today, this unspoiled natural area remains a frontier, a quality that greatly enhances the monument's value for scientific study. In this example the managing agency has categorized the physical unit to be monuments therefore, this asset would be considered one unit under the monuments category.[35]

61. Example 3: The Statue of Liberty[36] and Ellis Island National Monument[37] are identified as HA because of their historical significance. Ellis Island was incorporated as part of the Statue of Liberty National Monument on May 11, 1965. The entity has selected "National

[34] Grand Staircase also has a long and dignified human history; it is a place where one can see how nature shapes human endeavors in the American West, where distance and aridity have been pitted against our dreams and courage. The monument presents exemplary opportunities for geologists, paleontologists, archeologists, historians, and biologists.

[35] Congress granted the President authority to designate national monuments in the Antiquities Act of 1906, which specifies that the law's purpose is to protect "objects of historic or scientific interest." In addition to national monuments created through presidential action, Congress establishes national monuments by passing a law to create each individual monument with its own purpose (generally to protect natural or historic features).

[36] The Statue of Liberty was dedicated on October 28, 1886, and was designated a National Monument on October 15, 1924. Located on 12-acre Liberty Island in New York Harbor, the Statue of Liberty was a gift of international friendship from the people of France to the people of the United States and is one of the most universal symbols of political freedom and democracy.

[37] Ellis Island was incorporated as part of the Statue of Liberty National Monument on May 11, 1965. Between 1892 and 1954, approximately 12 million steerage and third class steamship passengers, who entered the United States through the port of New York, were legally and medically inspected at Ellis Island.

Monuments” as a HA reporting category and appropriately reports these HA in that category.

62. Example 4: An agency has archeological sites distributed across large tracts of agency managed lands. The lands have a very diverse topography and accessibility is difficult. These assets are evaluated as to their significance, have distinct public value, and they are recognized for research potential yielding scientific information or supporting management decision-making, interpretation, education, or economic benefits. Thus, management has categorized them as HA. These HA are actively maintained within the agency’s stewardship program. This agency’s management has made a determination that to receive “significant” or “priority” status, the HA must also meet one or more of the following agency recognition criteria:

- Official designation;
- Prior financial investment in preservation, protection, interpretation, or use; or
- An agency approved management plan.

Stewardship Land

63. 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 in note disclosure. The appropriate level of categorization of SL use should be meaningful and determined by management based on the entity’s mission, types of SL use, and how it manages the assets.

Stewardship Land Examples

64. Example 1: An example of a multiple-use category includes SL for which legislation prescribes the multiple use that will be achieved or authorized on the same tract(s) of land including, but not limited to domestic livestock grazing, fish and wildlife development and utilization, mineral exploration and production, rights-of-way, outdoor recreation, and timber production.[38]

65. Because the legislation requires “multiple-use” of all of the natural resources related to the SL, with no single use being predominant, the major category of use is “multiple.” However, a description of the multiple uses should be presented. Categorization of SL could be disclosed by geographic management unit, such as a state or region or perhaps a lower level management unit such as a field, district, or area jurisdiction. The management units

[38] SFFAS 29 par. 34 and footnote 17 specifically exclude the natural resources related to the land.

could be reported consistent with the manner in which they are managed, that is, by a specific land use plan (or management plan), which specifies how the natural resources related to the land will be used over a long-term period (i.e., one or more decades).

66. Example 2: SL is categorized as recreational when this is the predominate use of the land. Within this category, the physical units could be reported as a region, park, district, or other field unit jurisdiction.

67. Example 3: SL can also be categorized by function. Land can support such activities as education, transportation systems, and farming and grazing. For example, the mission of an agency may be to enhance the quality of life, promote economic opportunity, and carry out responsibilities to protect and improve trust assets such as providing schools and other opportunities for learning. Physical units within this category could be reported as townships, parcels, tracts, acres, or other units.

68. Example 4: An agency manages lands (that were formally public domain lands and were withdrawn)[39] for the purpose of constructing statutorily-authorized federal water projects and their associated canals, laterals, and drains to (a) provide water for agricultural, municipal, and industrial uses; (b) maintain flood control; and (c) generate power. In this federal water projects category, the number of units could be the number of major projects consisting of numerous related divisions, units, features, or facilities.

Quantification

General Issues

69. SFFAS 29 requires HA/SL to be quantified in physical units, rather than in monetary terms.[40] However, SFFAS 29 does not define the term "physical units" or specify which physical units should be used to quantify the variety of HA/SL categories and subcategories held by federal entities. Accordingly, quantities may be reported in a manner consistent with data available from existing management systems.

70. Physical units could consist of: items to be counted such as monuments, museum collections, facilities housing museum collections, parcels, tracts, sites, regions, districts, locations, management units; or units of measure such as inches, linear feet, square or

[39] "Withdrawal" of public lands means the removal or withholding of public land, by statute or Secretarial Order, from operation of some or all of the public land laws.

[40] SFFAS 29, par. 25 and 40.

cubic area (feet or yards), acres, miles, or kilometers. There may be other metrics to use in quantifying HA/SL not listed here.

71. However, counting physical items may not be necessary, particularly for collection-type HA, such as books and records contained in libraries. It may be 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. For SL, it may be appropriate to define the physical unit as regions or areas (where regions and areas are management jurisdictions) and then count and disclose the number of regions, areas, or acres, depending on the relevance of the metric used and the cost/benefit of capturing the information.

72. The above discussion highlights the need for management to differentiate between (a) detailed records that may be needed for management control and safeguarding purposes, and (b) financial statement reporting purposes for note disclosures. Many entities have stewardship responsibilities and control systems that can be traced to public laws or administrative rules. As good stewards, they may track individual assets and asset categories for control purposes that do not warrant separate presentation or disclosure in their financial reports. On the other hand, agencies also need to determine if there are legal or regulatory requirements for reporting HA/SL in the financial statements. Regardless of how the entity chooses to disclose, reporting should be done consistently. Also, as noted in SFFAS 29 par. 82 of the Basis for Conclusions, management should document its reasoning for the categorization and unitization.

Heritage Asset Examples

73. The following examples represent potential approaches for quantifying heritage assets in the footnote disclosure.

74. Example 1: Wild and Scenic is a river designation that can be bestowed by Congress. In this example, the agency manages multiple Wild and Scenic rivers and quantifies them in terms of the number of rivers. This presentation is at a higher level of aggregation than is required to meet management objectives, which may include the number of river miles, types of river miles (i.e., recreational, scenic, or wilderness), river segments, and other aspects of river management needed to fulfill mandates required by public laws and regulations.

75. Example 2: Similarly, national scenic trails are congressionally designated. An entity may report the number of trails it manages even though it may not manage the entire length of certain trails.[41] Additional data on these trails, such as the portion of each trail the entity is responsible for managing, exists within their management systems but does not have to be reported in the financial footnote disclosure. However, the entity may choose whether to report this supplemental data in its financial report as other supplementary information.

76. Example 3: Certain National Historic Landmarks are congressionally designated. An entity may choose to report only the number of landmarks under this category, even though these landmarks may contain multiple properties within each landmark. Another entity which also reports National Historic Landmarks may instead choose to report the properties within each landmark. Both of these reporting methods are acceptable under SFFAS 29.

77. Example 4: Archives, which include, but are not limited to, paper records and manuscripts, could be reported in cubic feet such as 238 million cubic feet or 211 collections. In terms of archived electronic documents, the disclosure could be to report such records in number of logical data such as 30 million or 830 collections.

78. Example 5: Museum items discovered on SL and managed in connection with HA include, but are not limited to, dinosaur bones, fossilized remains or traces of dinosaurs, herbarium specimens, mammals, insects, cultural objects depicting early human occupation, architecture, engineering, and American history. The museum items are maintained and managed to professional standards by federal and non-federal repositories. The entity has determined that it will report these assets based on the number of facilities (repositories) housing the museum items (collections). This categorization is suitable for the entity given the latitude allowed by SFFAS 29 regarding reporting relevant and reliable information on aggregation of units.

Stewardship Land Example

79. Reporting for each major category of SL use should include physical units by major category of use.

80. Example 1: An agency is organized largely by the states in which it has management responsibility for SL. Within each state there are jurisdictions that are smaller management units sometimes identified as field offices or districts. Within a field office there are smaller management units identified as area offices. This agency has selected the field office level as the “physical unit” for reporting its accountability over SL. This physical unit was selected

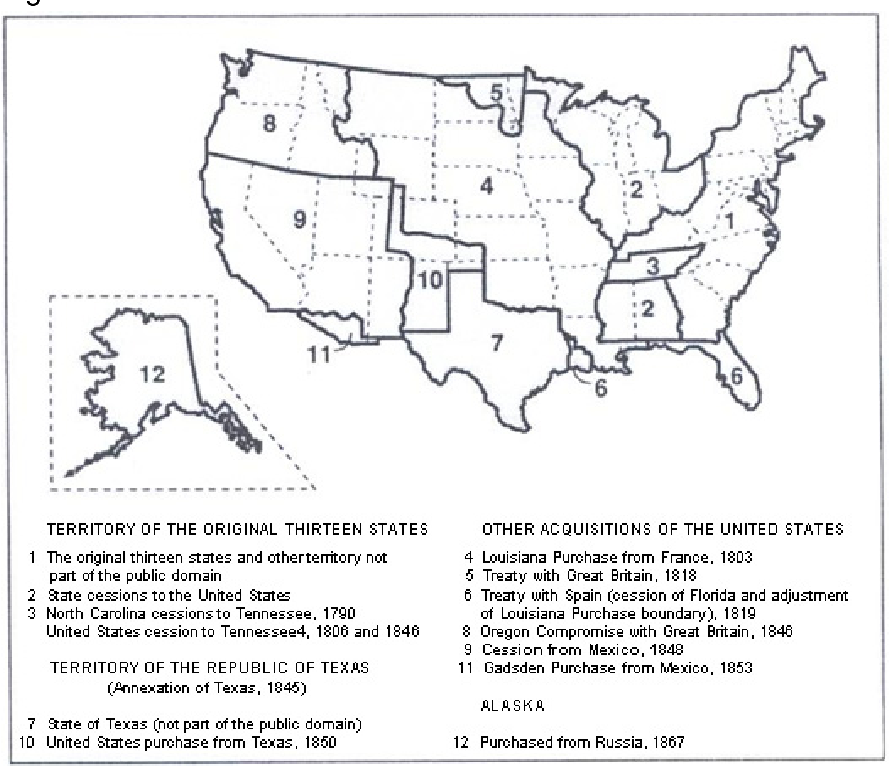
[41] Many trail systems consist of segments managed by one or more federal agencies as well as by non-federal entities. For purposes of this example, each federal agency would be responsible for disclosing that which it manages.

because the agency usually develops its land use plans at this level although certain parcels of land within a field office may require a distinct plan separate from the rest of the management unit. The agency has 118 field offices and based on its assessment, it is most appropriate to report 118 physical units of SL.

Supporting Documentation

81. In the Basis for Conclusions of SFFAS 29, par. 86-88, the FASAB briefly discusses the fundamental problems associated with providing corroborating documentation to auditors on historical assets which predate the effective date of the standard, and were acquired in an environment in which the historical records were not required to be retained and therefore may not exist or be inadequate. The following section addresses some of the complexities associated with documenting America's stewardship lands and heritage assets.

Figure 1:



82. The public domain once stretched from the Appalachian Mountains to the Pacific. Of the approximate 1.8 billion acres of public land acquired by the United States, about two-thirds went to individuals, corporations, and the states. The remaining public domain was set

aside for national forests, wildlife refuges, national parks and monuments, and other public purposes.

82. The majority of the public domain that remains today is stewardship land. As identified in the above graphic, this land was acquired through various purchases and cessions prior to 1870. During these early periods (1776 to the early/mid 1900s) few envisioned the need for the kinds of records, documents, and statistics that are required today. Acquisitions and disposals of land, whether from purchase, cession, or treaty, were not documented in the same manner as land transactions in more modern times. For example, as identified in item 6 of the above graphic, the boundary of the Louisiana Purchase was not well defined which led to a dispute between Spain and the United States resulting in the boundary adjustment of 1819. Surveys of the public land east of the Mississippi River began in 1785. Two years later, survey of only 4 ranges (about 144 square miles) had been completed. Much of the stewardship land remains unsurveyed today.

83. Definitive documentation on the majority of these lands is not available; therefore management must choose alternative methods of satisfying management's assertions for these assets. For assessing land, for example, these alternatives could mirror areas defined in the "Categorization" section of this document, such as the number of areas of recreational use, geographic management areas, and federal water projects of fish hatcheries.

84. HA also have many of the same documentation problems since antiquities laws and preservation acts did not go into effect prior to artifacts having been collected and preserved. Many of these assets may reside in federal and nonfederal repositories. However, records and detailed listings from these periods generally do not exist. In more recent times, legislation has strengthened the laws and rules regarding preservation and documentation over these assets.[42]

Methodology for Developing Supporting Documentation

85. Ideally, agencies should have a historical file evidencing ownership of HA/SL. But, when original property records or other documentation (for example, deeds, tax assessments, insurance records, etc.) for HA/SL do not exist, a methodology needs to be employed in

[42] For example, The Antiquities Act of 1906 provides authority for the President to establish National Monuments and gives authority to the Secretaries of Agriculture and Interior to issue permits for investigation and collection of resources from federal land and for collections . . . to be made for permanent preservation in public museums; The Museum Properties Management Act of 1955 authorizes the Secretary of the Interior through the National Park Service to preserve objects found within individual national parks; and the National Historic Preservation Act of 1966 directs the Secretary of the Interior to promulgate regulations that ensure that significant prehistoric and historic artifacts and associated records are deposited in an institution with adequate long-term curatorial capabilities.

order to develop alternative documentation to support management's assertions of federal ownership. For example, maintenance or renovation contracts, historical maintenance records or a history of payment of invoices, minutes of meetings, historical data bases, surveys of land records, a history of past/historical practices (e.g., establishing defacto ownership), or other relevant sources of information may provide acceptable alternative evidence of government ownership of HA/SL.

Section III. Assessing and Reporting Condition

Statement of Federal Financial Accounting Standards 42, Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32, rescinded the requirement to report condition information regarding heritage assets and stewardship land as RSI. The following guidance offers insights regarding condition assessments and factors that may influence reporting of deferred maintenance and repairs information. The guidance has not been updated to conform to the new standards and should be considered other literature until revised implementation guidance, if any is provided.

Assessing Condition

86. The condition[43] of HA/SL is to be reported as RSI unless it is reported elsewhere in the report containing the basic financial statements.[44] For consistency, condition should generally be reported for asset categories, rather than for individual assets.[45] However, the assessment of condition for HA/SL, which have a unique nature and specialized use, does not always lend well to traditional physical assessments such as "good," "fair," and "poor."[46] Such assessments are usually applied to items of general PP&E that break, wear out, or become obsolete while in service.

87. Traditional condition assessments or evaluations typically compare the current condition of an operating asset (such as a piece of equipment) against its original condition. As such, traditional condition assessments provide some indication of an asset's status in its useful life cycle, i.e. the asset's ability to perform as planned for the expected period of time. However, unlike items of general PP&E whose utility is expended over time in order to

[43] SFFAS 29 par. 41 footnote 22 gives a detailed explanation of condition, and par. 57 discusses the reasons for reporting condition as RSI. In addition, SFFAS 6 par. 77, 78, and 81 and footnotes 58 and 62 provide some insight into condition.

[44] SFFAS 29 footnote 11 states in part: "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."

[45] See par. 81 and 84 of SFFAS 29 for more details.

[46] For example, the existing state of the Liberty Bell (i.e., cracked and unable to ring) does not necessarily mean that the condition of the bell is poor.

produce goods or services, HA/SL generally have an unlimited or indeterminate useful life or are expected to be preserved indefinitely.

88. Agencies may assess the condition of HA/SL as a function of their day-to-day operations and document condition through periodic assertion/assessment statements provided by their field office managers. In order to make these assessments, management should consider developing criteria or guidelines to enable agencies to assess condition.

89. Agencies also need to evaluate the cost and benefits of doing **condition assessment surveys**. Such things as cycling the assessments on a rotating basis, the frequency of assessments (i.e., every 3 or 5 years) and the criteria and methodology used for making such assessments need to be considered. Management needs to document the procedures and methodology used on a consistent basis.

90. Although it is not possible to explicitly cover every circumstance that may arise, the examples presented in this technical release are intended to provide preparers with a broad range of acceptable methods for assessing and reporting condition consistent with the purposes intended by SFFAS 29. This technical release provides the foundation for preparers to exercise judgment in formulating their course of action.

Develop Criteria for Assessing Condition

91. The appropriate criteria for assessing condition depend on factors such as the agency's mission, the nature of the assets, the purpose for which they are managed, and their intended use. The criteria that are used by an agency to assess condition should be explained in suitable detail in RSI.

92. An agency could determine the condition of some of its HA/SL through site monitoring. The agency leverages its resources through partnerships with state, local, tribal organizations, other law enforcement personnel, and other volunteers under the direction of agency scientists to monitor thousands of sites annually. The heritage and stewardship land sites are visually inspected using previously prepared maps, photos, current land uses, site forms, and other baseline data to monitor and document changes and determine trends and condition of the site as compared to the condition when the site was first discovered. At-risk sites are usually monitored more frequently than sites that have remained stable.

Reporting Condition

93. According to SFFAS 29, par. 26, 27, and 41:

Entities should report the condition of the heritage assets (and stewardship land) (which may be reported with the deferred maintenance information) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information if reported elsewhere in the report containing the basic financial statements. 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.

Heritage Assets

94. Condition information for HA and the different categories of HA should fit the particular situation and circumstances. The emphasis should be on evaluating the efforts to preserve HA in the same state as when they were discovered. Additionally, for some categories condition information should be reported on individual HA, while condition information for other categories is more appropriately reported for a collection.

95. The primary focus for museum collections is preservation. Great attention is given to: (1) stabilizing objects in the condition in which they were received; and (2) preventing further deterioration. Documenting facility preservation procedures to "**safeguard**" assets (i.e., adequately protected, properly managed, and not materially degraded while under government care) may be more appropriate than assessing individual objects as having good, fair, or poor condition.[47]

96. As previously noted, HA are generally expected to be preserved indefinitely.[48] However, this expectation needs to be tempered with the understanding that all physical things will ultimately deteriorate. For example, in the restoration of the historic flag, “Old Glory,” the painstakingly careful work to remove the flag from an old linen backing could have caused some damage to the flag itself. Moreover, many of the flag’s woolen threads are already cracked as a result of flapping in the wind, aging, and exposure to light. The goal of safeguarding is to preserve HA for as long as possible, and to manage their condition in accordance with their intended use and not to unduly hasten their deterioration. [49]

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[47] The Basis for Conclusions to SFFAS 6 highlights the importance of safeguarding HA/SL.

[48] SFFAS 29, par. 16.

[49] SFFAS 6, Basis for Conclusions, par. 125 states that the government "...must demonstrate that it is being an appropriate steward for these assets..." and must be able to answer basic questions such as "Is the government effectively managing and safeguarding its assets?" Note disclosures should answer this question. However, the assertion that HA are safeguarded is a significant statement that implies management controls are operating effectively, and entities making this assertion should have a credible basis for doing so.

Heritage Asset Examples

97. Example 1: An Indian cliff dwelling may be discovered with only three remaining walls. The fact that the wooden roof has long since rotted away and one wall has fallen due to climatic conditions over many years does not mean that the remaining structure should be judged to be in poor condition. The original function of the cliff dwelling as living quarters is no longer relevant, but it must now be viewed in terms of its archeological value. Thus such a structure may be viewed to be in "acceptable" or "satisfactory" condition because either its particular state indicates that it will be preserved indefinitely or any necessary intervention has been accomplished to avoid further deterioration. Should there be a real possibility that another wall could collapse due to erosion from climatic conditions; the condition may be evaluated as "needs intervention" or "threatened."

98. Example 2: The condition of museum collections may be evaluated in terms of a specific facility's methodology used to preserve the assets, (i.e., the facility curating the museum collection), rather than by individual assets or collections.[50] For example, pre-historic pottery that is retrieved from an archeological dig in broken pieces cannot be classified as being in "poor" condition. The original function of the pottery as a container to store water is no longer relevant, but rather it must be viewed in terms of its value to understand a pre-historic culture. However, the item could deteriorate beyond the condition in which it was found through improper care.

99. Museum collections unlike other HA are curated in a special facility. The criteria for reporting museum collection condition information is based directly on the facility housing the museum collection itself, because the facility determines whether the collection, as a whole, is in stable condition. Numerous factors such as temperature, relative humidity, and dust and pest control are used to evaluate facilities to determine their ability to minimize any deterioration that could happen to its contents.[51] Consequently, a museum collection housed in a facility meeting museum conservation professional standards may be properly viewed as being in "acceptable" condition. A museum collection housed in a sub-standard facility can be viewed as being in a state "requiring intervention."

Rehabilitation of HA

100. Rehabilitation of a HA, to make possible a compatible use for that asset through repair, alterations, and additions while preserving those portions or features that convey its historic,

[50] SFFAS 29, par. 16 and par. 81.

[51] This methodology is consistent with standard professional museum practice as recommended by museum conservators and museum associations.

cultural, or architectural values, may turn it into a multi-use heritage asset. Condition information would not be based on comparing the asset to its original, new state, nor to its state at the time it was first recorded or documented by archaeologists, but would rather be based on comparing the asset to its condition at the time it was originally rehabilitated. In this example, the rehabilitation work and resulting use in government operations moves the asset from the HA category to a multi-use HA category and as a result, it is reported as general PP&E. As such, the cost of the rehabilitation work would be capitalized and the property would be reported on the balance sheet with an appropriate value.

101. Some former HA have been recreated at the same site, and according to the same design using contemporary materials, as the original assets. Some of these recreations are not HA while some others have been determined to complement or add to the significance of the site and any condition information on the recreation may fall within the purview of general PP&E or HA depending upon its classification.

Stewardship Land

102. Based on guidelines and criteria established by agencies for assessing condition, a key to the evaluation of land is whether it is capable of fulfilling its primary use. For example, land condition could be considered acceptable when it is capable of supporting one or more of its authorized uses. On the other hand, land condition may be considered unacceptable when intervention is needed due to environmental contamination that will cause humans or wildlife to be injured by virtue of their proximity to the contaminated land. Under such circumstances, readers would be referred to the environmental cleanup liability note in its financial statements for information as applicable.

103. The following discussion describes some of the relevant factors that exist as to why it is difficult to apply the concept of "condition"[52] to the definition of land provided in the standard.[53]

104. Land exists as a result of thousands, millions, or billions of years of events such as volcanoes, earthquakes, fire, floods, erosion, collisions with cosmic debris, and so on. These are all natural events that are both creative and destructive. They formed the land and may also cause its destruction. Agencies are not able to easily assess the durability, obsolescence, or quality of design and/or construction of land like agencies do for constructed assets.

[52] SFFAS 29 par. 41, footnote 22.

[53] A solid part of the surface of the earth exclusive of depletable and renewable natural resources.

105. Land is also not subject to factors, such as accidents, catastrophes, disasters, and obsolescence within the same context as constructed assets because the physical state of land endlessly changes based on the forces of nature. Some natural forces have immediate effects on the asset, others, take weeks, months, or years, and still others, such as climatic changes or major geological events can produce a very long term effect. The concepts of “performing as planned,” “continued usefulness” and “performance capability” are difficult to apply to land. Land does not perform, it exists, recycles, and changes form depending on forces of nature.

106. The following provide examples of why the effects of natural occurrences of nature on the land are unpredictable.

- A lightning strike sparking a wildland fire would not have impact on the land itself but could devastate a plant community in a matter of minutes. However, that same fire could produce an invigorating effect on the plant community over the long term.
- Yellowstone National Park was so designated, in part, because of its geologic activity. The underlying volcanism that makes the park unique by producing hot springs, geysers, etc., will likely cause an immense change in its landscape at some point in the future.
- Under normal or average conditions, some soil erosion occurs due to flooding because of wind and water action on all land. In an event such as a flash flood, erosion occurs at an accelerated rate, even leaving the formation of gullies with unstable banks as vegetation cover is swept away in a flood. Heavy rains with a movement of water across a naturally barren landscape can lead to short-term undesirable effects. However, in the long term, gullies are stabilized by the vegetation that grows back and become the natural course for water to take in future years when rainfall occurs. These natural processes (erosion and stabilization) occur with or without human intervention and may not be "prevented" by any "condition" of the land.
- Drought is inevitable and has tremendous ecological and socioeconomic consequences. Both short-term and long-term droughts significantly impact natural resources and human lives. During short droughts, the lack of moisture typically causes reduced plant and animal productivity. Persistent droughts, characterized as several consecutive years with below average precipitation, are more infrequent but may be widespread and can result in significant economic and ecological stress and ecosystem alterations.
- When short or long-term droughts subside and precipitation returns to normal or above normal levels, the vegetative resource can respond dramatically and the land can quickly return to its natural state. Various desirable (and sometimes undesirable seeds) that have been lying dormant in the soil for years will germinate and vegetative growth can be extensive. Such was the case in

Arizona in 2005. After a 7-plus year drought, the rains came at the right time and native vegetation flourished; so much that during 2006 there were many fire hazards.

107. Agencies do not typically perform maintenance on land. Unlike constructed assets, land does not meet the definition/description of maintenance--the act of keeping fixed assets in acceptable condition. Maintenance includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve an asset so that it continues to provide acceptable services and achieves its expected life. The type of activity (maintenance) as described herein is not scheduled, performed, or deferred on land.

108. While condition is not easily applied to land, it can be readily applied to constructed changes to the land that require recurring maintenance, such as a constructed marsh specifically built to provide habitat. Another example is land that has been contaminated by the release of hazardous substances or land that has been used to store, treat, or dispose of hazardous wastes. This information should already be disclosed in the notes to the financial statements as environmental liabilities and could be referenced in the stewardship note.

Stewardship Land Examples

109. Example 1: An agency has a mission of conserving, protecting, and enhancing fish and wildlife and their habitats. Accordingly, the ability of the agency's land to provide integrated habitat and life support for permanent resident populations and for migratory populations might provide a criterion to evaluate its condition. For example, does the land support sufficient vegetation to provide habitat for native species or are coastal or other marshes sufficient to support migratory bird populations? The agency would evaluate its land against these criteria and the results of this evaluation may be that the condition of the land is sufficient to support the mission of the agency (i.e., the land provides integrated habitat and life support for permanent resident populations and for migratory populations) and such condition would be disclosed. If the agency had constructed habitat by changing the land and if that constructed habitat required recurring maintenance that either was or was not performed, then the condition of the constructed habitat could be disclosed.

110. Example 2: An agency manages a small portion of the land under federal ownership for which it is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity, which have created a public health or environmental risk. The contaminated sites covering about 10% of the agency's SL have resulted from nuclear-powered aircraft carriers, submarines, and other nuclear ships or from the stockpile of lethal or incapacitating chemical warfare agents and munitions. These contaminated sites that make the surface of the earth uninhabitable by people would be listed in the

environmental cleanup liability notes to the agency's financial statements. The SL condition disclosure could identify these areas and report their condition as unacceptable.

111. The condition of the agency's non-contaminated lands might be disclosed as sufficient to support the mission of the agency based on the agency evaluating this land in relation to its mission. If insufficient budgetary resources or other intervening factors prevented the mitigation of the environmental contamination, the agency would disclose this information (as applicable) in its environmental cleanup liability note to the financial statements and could reference that note in its stewardship note disclosure. The agency would also report the estimated cost of environmental cleanup as deferred maintenance in accordance with environmental liability standards.[54]

[54] Standards for determining and reporting deferred maintenance are contained in SFFAS 6, which requires disclosures related to the condition and the estimated cost to remedy deferred maintenance of PP&E.

Section IV: Government-Wide Reporting

SFFAS 29 requires a balance sheet note reference and a note disclosure of HA/SL information in the U.S. Government-wide financial statement. The government-wide balance sheet should reference a note that discloses information about stewardship land and heritage assets, but no asset dollar amount should be shown. The note disclosure should include a brief statement explaining how HA/SL relates to the mission of the federal government; a description of its predominant uses; and a general reference to agency reports for additional information about HA/SL. The Government-wide financial statement should also 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.

Appendix A: Basis for Conclusions

A1. The HA/SL taskforce that developed this technical release was comprised of over a dozen different entities, varying in size, with experts in the field who had significant responsibility for heritage assets and/or stewardship land. The taskforce approached this implementation guide project by addressing the specific areas in SFFAS 29 that focus on identification, categorization, quantification and condition of these assets. The taskforce believed that the most meaningful information to guide preparers was through examples of how entities currently or in the past have identified, categorized and quantified heritage assets and stewardship land, as well as how they assessed their condition.

A2. This technical release provides a variety of examples that are representative of the many types of stewardship assets in existence. In addition, this technical release provides numerous ways to disclose heritage assets and stewardship land since SFFAS 29 allows entities considerable latitude and flexibility in achieving the objective of relevant and reliable information for users.

A3. Typically standards or technical releases do not address materiality. The taskforce believes that since no dollar amounts are assigned to these assets and that traditional materiality judgments about financial information are primarily quantitative and focused on dollar amounts that materiality needed to be addressed. Thus, the taskforce provided an approach for considering materiality to give preparers implementation guidance in applying materiality to heritage assets and/or stewardship land.

A4. As a result of the taskforce deliberations, it reached a consensus on the material presented in this technical release.

A5. The exposure draft, *Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land*, was issued June 11, 2007 with comments requested by August 13, 2007. Four comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others	0	1
Auditors	0	0
Preparers and financial managers	3	0

A6. The Committee considered responses to the exposure draft at its September 27, 2007 AAPC meeting. The majority of the respondents agreed with the proposed guidance. Specific concerns were raised by several respondents related to developing supporting documentation when property records do not exist. The Committee believes there are number of ways to develop acceptable alternative documentation to support management's assertions of federal ownership of heritage assets and stewardship land. Par. 85 is revised to address these concerns. In addition, clarifying language was added to par. 45-46 to help preparers in determining whether land meets the criteria for general PP&E land, stewardship land, and land rights as defined in SFFAS 29. Also, the technical release has been revised to highlight that the examples used in assessing and reporting condition provide a broad range of acceptable methods consistent with the purposes and intent of SFFAS 29. Finally, clarifying edits, revisions, and helpful examples were added to address commentators concerns.

Appendix B: Excerpts from SFFAS 29 Heritage Assets and Stewardship Land

See SFFAS 29, par. 1-105.

Appendix C: Illustrative Disclosures

PLEASE NOTE: Appendix C illustrates Heritage Assets and Stewardship Land disclosures at the component entity level. These illustrative disclosures may only include selected portions of a full disclosure as required by SFFAS 29. These illustrations are considered non-authoritative guidance and are not required to be followed.

Footnote Disclosure

Heritage Assets:

Example 1: (Par. 25 a. and b. of SFFAS 29)

The Library of Congress classifies its collections as HA: assets with historical, cultural, educational, artistic or natural significance. Its mission is to maintain a universal collection and provide access for current and future generations. The Library's collection development policies are designed to fulfill its responsibilities to serve (1) the Congress and United States government as a whole, (2) the scholarly and library community, and (3) the general public. Written collection policy statements ensure that the Library makes every effort to possess all books and library materials necessary to the Congress and various offices of the United States government to perform their duties; a comprehensive record, in all formats, documenting the life and achievement of the American people; and a universal collection of human knowledge embodying primarily in print form the records of other societies, past and present.[55]

Copyright deposits are a major source of the Library's collections of Americana. The Library also acquires materials by purchase, transfer from other federal agencies, gift, domestic and international exchange, or by provisions of state and federal law. Many of these materials are foreign publications. Various preservation methods are used to maintain the collections, and disposals occur only for the exchange and gift of unwanted or duplicate copies.

Stewardship Land:

Example 2: (Par. 40 a. - d. of SFFAS 29)

[55] Clinical medicine and technical agriculture are the responsibilities of the National Library of Medicine and National Agricultural Library, respectively.

Agency X meets its mission by managing the lands and their various resources so that they are utilized in the combination that will best meet the needs as well as the enjoyment of both present and future generations of the American people. These resources include both natural and cultural HA of scenic, scientific, and historical value. The management of the lands and their associated HA are the essence of the Agency's mission.

The agency has been entrusted with stewardship responsibility for the management of natural resources on and beneath America's SL as legislated through P.L. 94-579. Land use plans, developed with public involvement, are the mechanism by which use and levels of use are determined. The agency is required to develop, maintain, and, when appropriate, revise land use plans that divide the land into tracts or areas.

The agency's stewardship mission is to be environmentally responsible for commercial and non-commercial uses of the natural resources (depletable and renewable) associated with SL. P.L. 94-579 prescribes the uses that will be achieved or authorized on the land. The agency has 4 major categories of use: multiple; recreation; cultural, schools, and housing; and reclamation/irrigation. (The agency will provide a description of each major category of use in its note disclosure.)

1. Multiple use:

   a. Grazing:
   b. Wildlife:
   c. Minerals:
   d. Rights-of-Way:
   e. Recreation:
   f. Timber:

2. Recreation:

3. Cultural, Schools, and Housing:

4. Reclamation/Irrigation:

The agency reports its physical units of SL by management unit. The "management unit" jurisdictions represent the management level at which specific management plans are developed and implemented to manage the natural resources related to the land for both present and the future periods.

Agency A Stewardship Lands as of September 30, 200X

Category of Use	**200W Balance**	**200X Additions Note 1**	**200X Withdrawals Note 1**	**200X Net Change**	**200X Balance**	**Condition Note 2**
Multiple Use	118	2	3	-1	117	Acceptable
Recreation	388				388	Acceptable
Cultural/Schools/				1		
Housing	79	1			80	Acceptable
Reclamation/			1	-1		
Irrigation	221				220	Acceptable
Total	**806**	**3**	**4**	**-1**	**805**	

Note 1: Describe the major methods of acquisition and withdrawal of SL during the reporting period.

Note 2: Describe what constitutes acceptable and unacceptable condition.

Example 3: American Battle Monuments Commission

Significant Accounting Policies (Par. 25 a.- d. of SFFAS 29)

Heritage Assets (could be combined with Property and Equipment note)

The Commission's stewardship policies are designed to be responsive to the overall mission of the Commission to design, construct, and maintain cemeteries and memorials. Heritage Assets are assets possessing significant cultural, architectural, or aesthetic characteristics. The Commission considers its cemeteries, federal memorials, monuments, and markers acquired through purchase or donation to be non-collection HA. HA are acquired through purchase or donation, are accounted for in the Commission's property records, and are not presented in the balance sheet. Withdrawals of HA are recorded upon formal agreement with recipients. Additional disclosure on individual heritage asset cemeteries and memorials are found in the Schedules of HA presented as unaudited supplementary information. Cemetery land is owned by the foreign countries in which cemeteries are located and is provided to the United States in perpetuity.

Heritage Assets

Heritage assets are significant to the mission of the Commission. The Commission presents its HA in three categories; cemeteries, federal memorials, and nonfederal memorials. Changes in HA for fiscal year 20XX were as follows:

	Cemeteries	Federal Memorials	Non-Federal Memorials
Beginning of Year 10-1-XX	24	25	4
Number Acquired, Fiscal Year XX	0	0	2
Number Withdrawn, Fiscal Year XX	0	0	0
End of Year 9-30-XX	24	25	6

The Commission assumed responsibilities for private memorials for the 147th Engineer Battalion and the 507th Parachute Infantry Regiment during fiscal year 20X2. Through September 30, 20X2, Commission cemeteries contain over 131,000 interments. Over 94,000 Honored War Dead, whose remains were not recovered, are memorialized in the cemeteries and federal memorials that encompass over 1,600 acres. This land is provided to the Commission through host agreements with foreign countries for permanent use as cemeteries and memorials.

Required Supplemental Information (RSI) Disclosure (Par. 26 of SFFAS 29)

The following illustrates sample disclosure of condition information for the American Battle Monuments Commission under SFFAS 29. Disclosure of condition information is also illustrated for the Library of Congress. However, agencies may develop and use other disclosures to fit their circumstances as deemed necessary.

Example 4: American Battle Monuments Commission

Condition assessment surveys, using a five-point scale of one (excellent) to five (very poor), identify needed future maintenance and repair projects at cemeteries and memorials in order to maintain real property and heritage assets in an acceptable condition of three (fair) or better. These surveys are reviewed and updated at least annually by the Commission's engineering staff. In addition, engineering projects identified improvements in cemetery irrigation, drainage, roads, parking areas, and buildings. As of September 30, 20XX, the Commission has identified a total of 333 maintenance, repair, and improvement projects, with an estimated cost of $15.8 million, to be performed in future years, subject to available funding.

Example 5: Library of Congress

The Library of Congress has the world's largest library collection, including research materials in over 450 languages and various media. Providing access to this collection inevitably puts it at risk and could impair the Library's ability to serve the Congress and other users in the future. However, the collections exist to be used, and management accepts the responsibility of mitigating risk to the collections at the same time it fulfills its mission of service to the Congress and the nation. Therefore, the Library has chosen to balance the usage of the collection with the long-term preservation requirements of the collections.

As of September 30, 20XX, the collections were determined to be in a useable condition for fulfilling its service mission. During fiscal 20XX, only a very small percentage of materials were removed from the collection because of damage caused by use and/or deterioration of the medium. The ultimate useful life of a library item varies by its medium (e.g., book, film, tape, manuscript, disk), and the manner in which it is used and stored.

The Library employs a variety of methods to prolong the useful life of its deteriorating materials, including:

- The establishment of adequate environmental storage conditions
- The usage of binding or other methods to house items
- The mass deacidification of print materials
- The use of surrogates in serving the collections to the public
- The reformatting of collections to other media

The Library has inadequate temperature and humidity control in some collections storage areas; inadequate space for appropriate storage of collections materials; insufficient space for reformatting the acetate negative collection; and insufficient funds for reformatting. These conditions cannot be fully addressed with current funds and physical plant. The move of collections into the storage facility at Fort Meade, Maryland, is serving to remedy many of these difficulties for books and paper-based materials, and the acquisition of the National Audio-Visual Conservation Center in Culpepper, Virginia, is a major step in the preservation of film and other media.

Technical Release 10: Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment

Status

Issued	June 2, 2010
Effective Date	Upon issuance
Affects	None.
Affected by	None.

Summary

This technical release is intended to address important implementation questions regarding the consistent application of TB-2006-1 as it relates to asbestos cleanup costs associated with facilities and installed equipment. As federal agencies develop their approach to implementing SFFAS 6 and TB 2006-1 for recognition of cleanup cost associated with asbestos, it has become apparent that an implementation strategy is needed to ensure consistent reporting of asbestos cleanup liabilities. Many federal agencies continue to struggle with interpreting SFFAS 6 and Technical Bulletin 2006-1 and determining a cost effective standard implementation methodology. This guidance provides additional clarification of SFFAS 6 and TB 2006-1 and a framework for identifying assets containing asbestos, assessing the asset to collect information and/or develop key assumptions in applying acceptable methodologies to estimate asbestos cleanup costs for federal facilities and installed equipment.

Table of Contents

Introduction

Purpose

1. In accordance with FASAB Technical Bulletin (TB) 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs:*

   a. Federal entities will (1) estimate both friable and non-friable asbestos-related cleanup costs and (2) recognize a liability and related expense for those costs that are both probable and reasonably estimable,[1] consistent with the current guidance in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant, and Equipment*, *Chapter 4: Cleanup Costs*; and Technical Release (TR) 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*.

   b. Federal entities will disclose information related to friable and non-friable asbestos-related cleanup costs that are probable but not reasonably estimable in a note to the financial statements, consistent with SFFAS 5, SFFAS 6, and TR 2.

2. This technical release provides a framework for identifying assets containing asbestos and assessing the asset to collect information and/or develop key assumptions in applying acceptable methodologies to estimate asbestos cleanup costs for federal facilities and installed equipment,[2,3] hereafter referred to as ”real property” in this document.

[1] The estimate shall be included as part of the “estimated total cleanup cost.” (SFFAS 6 par. 94)

[2]Includes those assets within general PP&E, heritage and stewardship categories

[3] Installed equipment “fixture” is defined in GAO-01-179SP Appropriation Law-Vol. IV (16-191) as those equipment items that are (1) permanently attached to the realty, or (2) if not permanently attached, (a) it is necessary and indispensable to the completion and operation of the building, or (b) the structure was designed and built for the purpose of housing the equipment.

Scope

3. The scope of this guidance is limited to federal real property[4] that contains any form of asbestos. It provides additional clarification of SFFAS 6 and TB 2006-1 for identification and recognition of asbestos-related cleanup costs, and provides a methodology for identifying and recognizing asbestos liabilities associated with federal properties.

4. Readers of this technical release should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board*. 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 clarifies, but does not change, guidance previously provided in SFFAS 5, SFFAS 6, TB 2006-1, and TR 2.

Effective Date

5. This technical release is effective immediately.

Background

Overview

6. Prior to TB 2006-1, "most federal entities had recognized liabilities for the removal of asbestos that posed an immediate health threat (i.e., friable asbestos), but many federal entities had not prepared an estimate of cleanup costs for the future removal of asbestos that did not pose an immediate health threat (i.e., non-friable asbestos). Therefore, it was determined that additional guidance was needed to clarify that entities need to estimate all asbestos-related cleanup costs and not just those costs related to asbestos that requires immediate cleanup."[5]

[4] For the purpose of this document, real property is defined as federal facilities and installed equipment; and includes 1) real property acquired through capital leases, including leasehold improvements; and 2) real property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or federal contractors).

[5] TB 2006-1, Summary II

7. As federal agencies continue to develop their approach to implementing SFFAS 6 and TB 2006-1 for recognition of cleanup costs associated with asbestos, it has become apparent that an implementation strategy is needed to ensure consistent reporting of asbestos cleanup liabilities. Many federal agencies continue to struggle with interpreting SFFAS 6 and TB 2006-1 while attempting to determine a cost-effective standard implementation methodology for identification and recognition of an estimated liability for asbestos cleanup.

Related Accounting Literature

8. The related accounting standards are as follows:

   a. SFFAS 5, *Accounting for Liabilities of the Federal Government*

   b. SFFAS 6, *Accounting for Property, Plant, and Equipment*

   c. TB 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*

   d. TR 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*

Technical Guidance

Methodology for Identifying and Estimating Cleanup Costs Associated with Asbestos

9. The following methodology is for identifying and estimating cleanup costs associated with asbestos. The methodology, described below and illustrated in Diagram 1, was developed on the premise that federal entities must 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." How this approach will be executed is at the discretion of the individual federal agency.

10. The following steps may be taken to identify real property that may contain asbestos.

    a. Review inventory listing of all real property.

b. Identify and eliminate all real property or group of real properties[6] on the list that are not expected to contain asbestos. Document the basis for elimination such as:

   i. Asbestos survey results, or other records indicating the real property(ies) or group of real properties is not likely to contain asbestos (e.g., the manufacture date for items not likely to contain asbestos could be considered);

   ii. Records indicating all asbestos was previously removed from the real property(ies); or

   iii. Asset type is not likely to have asbestos or not required to be surveyed for asbestos (e.g., railroad tracks, power lines, airfield pavements, roads, sidewalks, and land).[7]

c. Property remaining on the list should be expected to contain asbestos.

11. Once steps have been taken to identify real properties that are expected to contain asbestos, each real property or group of real properties should be assessed to collect the information in paragraphs a and b below. For purposes of developing asbestos cleanup cost estimates, reasonable assumptions[8] can be made in some cases to make up for a lack of actual data.

   a. The scope of asbestos removal required at real property(ies) renovation, disposal or demolition by determining the:

      i. Most likely method of real property renovation or demolition (e.g., use of heavy equipment, implosion/explosion, or manual methods); and

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[6] Real property may be sorted into groups by category, type, and/or locations. Examples of categories might include buildings, and other structures. Examples of types might include railroad tracks, power lines, and sidewalks. Locations may be facilities or sites recently built and known to be asbestos free. A combination of categories, types, and/or locations may also be used.

[7] In accordance with TB 2006-1, paragraph 6, this guidance regarding asbestos-related cleanup costs does not include naturally occurring asbestos (NOA) that can be found in soil, rocks and mines. NOA is contained in land, and land is considered to have an indefinite useful life. Therefore, NOA would appropriately be accounted for under the requirements of SFFAS 5.

[8]Assumptions include renovation or demolition method, the quantity and quality of asbestos to be removed (paragraphs11. a and b) and other information that affects cost (e.g., asbestos survey, sampling, removal, and non-routine materials management). As additional information becomes available, the federal entity should reevaluate its key assumptions and make necessary adjustments to the cost estimate and liability.

ii. Federal, state and local regulatory requirements governing asbestos management to identify added costs to standard demolition (e.g., asbestos surveys, sampling, removal, and non-routine materials management). Regulatory requirements must be considered to identify additional cost considerations that may differ by location such as extent of asbestos surveys, sampling, removal, and non-routine materials management.

b. The amount, type, location, and expected condition of asbestos and asbestos containing materials in the real property or group of properties by referring to available records, to include records of comparable assets in the same asset class, reasonable surveys of the real property(ies) and/or real property construction information.

c. If the information above is either not available or not sufficient to support assumptions in lieu of actual data, yet the existence of asbestos has been identified in paragraph 10 above, then the removal of asbestos may be considered probable but not reasonably estimable at that time. The existence of asbestos and a statement that such an estimate cannot be made should be disclosed in the notes to the financial statements.[9] The agency should estimate and recognize any other identifiable costs (e.g., asbestos survey).

12. If sufficient information is available to develop a cleanup cost estimate or support key assumptions needed for the cost estimate, then one of the following estimating methodologies can be used for each real property or group of real properties to estimate cost of removal, containment or disposal.

a. A property-specific cost estimate based on survey data (most accurate, if available); or

b. An extrapolation of historical cost or cost estimates for asbestos cleanup of similar real property(ies); or

c. A cost model[10] used for an individual real property or group of similar real properties and information from industry-specific cost estimation publications or standardized cost factors developed for each state; or

d. Other reasonable methodologies.

[9] TB 2006-1, par. 49.

[10] A cost model is a framework upon which an estimating methodology is developed. The model may use mathematical equations to convert resource data into cost data and require users to enter a minimal amount of information to generate cleanup cost estimates.

13. Once the estimated asbestos cleanup cost associated with the removal, containment or disposal of the real property has been determined, that cost should be recognized in accordance with SFFAS 6.[11]

14. If the asbestos cleanup cost cannot be estimated using any of the methodologies in paragraph 12, the agency should estimate and recognize any other identifiable costs (e.g., asbestos survey) as outlined in TR 2 (*Section 2: Determining "Reasonably Estimable" Environmental Liabilities – (2.) Experience with Similar Site and /or Conditions*).

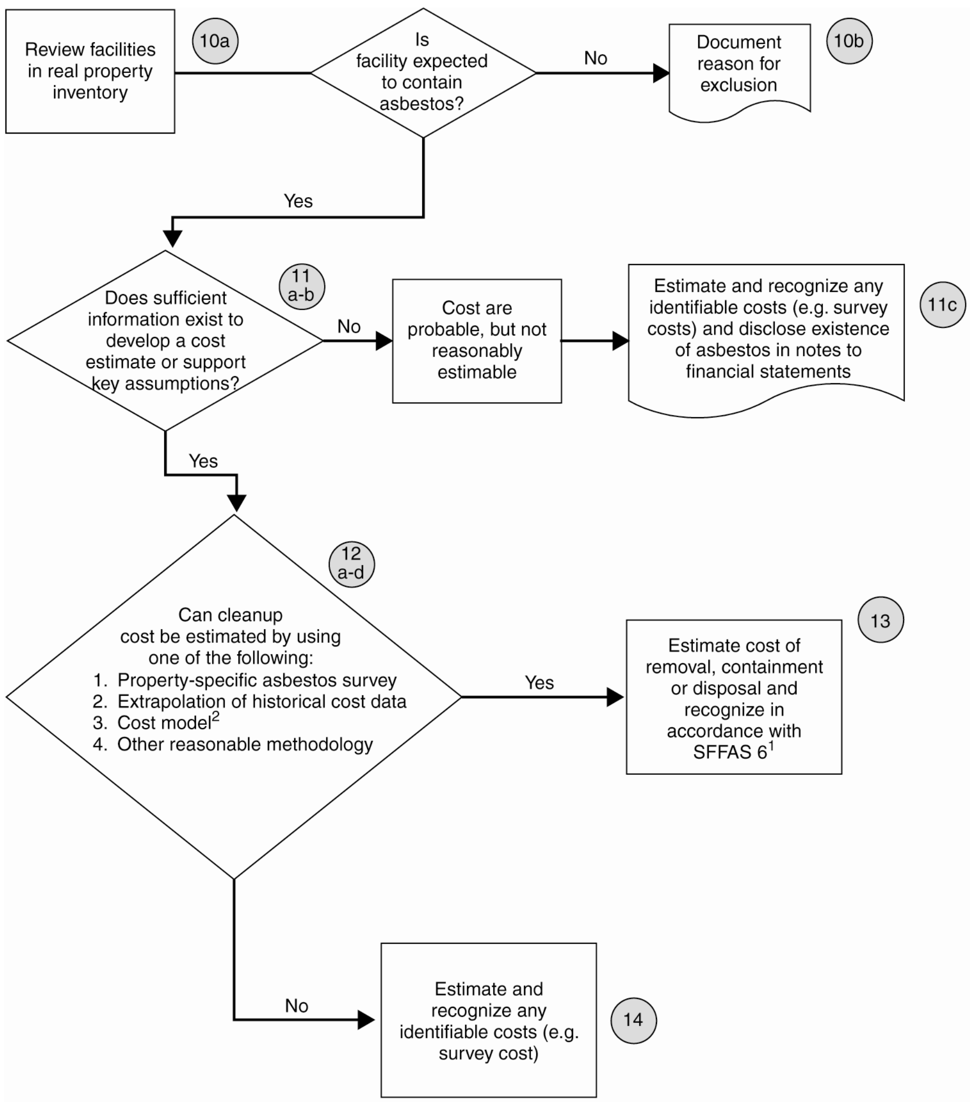
15. In accordance with SFFAS 6, paragraph 96, "Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing."[12] As additional information becomes available, key assumptions should be re-evaluated, cost estimate revised, and necessary adjustments made to the liability recognition.

[11] See paragraphs 98 and 101, and Technical Bulletin 2006-1, paragraph 37.

[12]TB 2006-1, paragraph 34: As reestimates are made, the cumulative effect of changes in total estimated asbestos-related cleanup costs related to current and past operations shall be recognized as expense and the liability adjusted in the period of the change in estimate (SFFAS 6 par. 99). In certain scenarios, such as when cleanup costs have been fully expensed, the reestimate may result in a credit to expense for that year.

Diagram 1: General Approach to Determining, Estimating and Recognizing Asbestos Cleanup Costs

(Circles correlate to Sections of document)



[1]In accordance with the requirements of SFFAS 6, pars. 97 & 101, and TR2.

[2]A cost model is a framework upon which an estimating methodology is developed. The model may use mathematical equations to convert resource data into cost data and require users to enter a minimal amount of information to generate cleanup cost estimates.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

Background

A1. In January 2008, the Accounting and Audit Policy Committee (AAPC), established the General Property, Plant, & Equipment (G-PP&E) Task Force to assist in developing implementation guidance for federal G-PP&E as it relates to SFFAS 6, *Accounting for PP&E, SFFAS 23, Eliminating the Category National Defense Property Plant, & Equipment, and other related G-PP&E Guidance developed by the FASAB.* The task force includes federal agency representatives who are experiencing G-PP&E implementation issues and those who have G-PP&E implementation best practices to share with the federal community.

A2. The AAPC G-PP&E task force was divided into four subgroups that will each address a set of related issues. Each subgroup meets separately on a regular basis to discuss its set of issues and report back to the full task force on its progress towards the development of implementation guidance. The four subgroups are:

- G-PP&E Acquisition
- G-PP&E Use
- G-PP&E Disposal
- G-PP&E Records Retention

A3. This guidance was developed by the Disposal subgroup. The subgroup included members from the following federal agencies:

- Department of Defense
- Department of Energy
- Department of the Interior
- Government Accountability Office
- General Services Administration
- National Aeronautics and Space Administration

Recognition versus Disclosure of Asbestos Cleanup Costs

A4. An asbestos cost estimate is developed in accordance with the methodology outlined in TR 2 once the existence of the asbestos is determined. If the asbestos is probable, the entity must determine whether the costs can be reasonably estimated. Asbestos cost estimates rely on information such as the amount, type, and condition of asbestos in the property, the disturbance activity, and the federal, state and local asbestos regulations. This information is not always available due to: a) absence of environmental or legal driver to track the existence of asbestos; b) asbestos embedded in materials not visible through observation; and c) changes in regulatory restrictions on the use of asbestos in materials. For purposes of developing asbestos cleanup cost estimates, assumptions can be made in some cases to make up for a lack of actual data. When reasonable assumptions and associated estimates (i.e. supported by industry best practices) cannot be made, the presence of asbestos and the inability to reasonably estimate an amount of the total cleanup costs should be disclosed in the agency's notes to the financial statements.

Asbestos Cleanup Cost Estimation Approach

A5. Cost estimates for future asbestos cleanup are dependent on information that is often not discovered until closer to initiation of a renovation or demolition project. As a result, cost estimates may be based on key assumptions that become more accurate as an asbestos cleanup project is planned. Thus, the methodology presented offers several options for developing cost estimates depending on the availability of asbestos information (i.e., cost model for individual or grouped properties, extrapolation of historical costs, property-specific cost estimate based on survey data). The methodology incorporates refinement of the cost estimate as better and relevant information becomes available over the life of the asset. Once a renovation or disposal project is planned and detailed asbestos surveys are conducted as dictated by environmental regulation, environmental liabilities should more accurately reflect future asbestos cleanup costs.

Reasonable Cost Estimate

A6. Management is responsible for making the accounting estimates included in the financial statements. Estimates are based on subjective as well as objective factors and, as a result, judgment is required to estimate an amount at the date of the financial statements. Management's judgment is normally based on its knowledge and experience about past and current events and its assumptions about conditions it expects to exist and courses of action it expects to take. An entity's internal control may reduce the likelihood of material misstatements of accounting estimates. The entity should consider the following factors when developing a reasonable cost estimate:

1. Accumulation of relevant, sufficient, and reliable data on which to base an accounting estimate.

2. Preparation of the accounting estimate by qualified personnel.

3. Adequate review and approval of the accounting estimates by appropriate levels of authority, including:

    - Review of sources of relevant factors
    - Review of development of assumptions
    - Review of reasonableness of assumptions and resulting estimates. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data
    - Consideration of the need to use the work of specialists
    - Consideration of changes in previously established methods to arrive at accounting estimates
    - Consideration of changes in the business or industry that may cause other factors to become significant to the assumptions

4. Comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates.

5. Consideration by management of whether the resulting accounting estimate is consistent with the operational plans of the entity.

A7. The AAPC released the exposure draft (ED), *Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment* on September 3, 2009. 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 committees of professional associations commenting on past exposure drafts.

A8. Nine letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors		
Preparers and financial managers	7	

A9. AAPC received a comment on the exposure draft requesting clarification on whether removal of asbestos could be classified as part of normal operations, when performed during maintenance, repairs or alterations that occur over the life of the building, and therefore the cost of removal could be accounted for as an operating expense and not a liability. Although the building maintenance and repair occurs periodically over the life an asset, any asbestos contained in a specific asset may not be periodically removed and/or contained at every scheduled repair and/or maintenance activity. Therefore, the removal of asbestos should not be accounted for as a routine operating expense. Further, in accordance with TB 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, paragraph 30, “it is possible for certain types of nonfriable asbestos-containing material to remain nonfriable indefinitely; therefore, the estimate does not need to include nonfriable asbestos-containing roofing, flooring, siding, and other materials that when repaired, renovated, removed, contained, disposed of, or otherwise disturbed do not become friable and do not require additional costs above and beyond normal repair, renovation, removal, containment, or disposal costs to prevent them from becoming friable. However, if there are additional costs incurred to prevent the nonfriable asbestos-containing material from becoming friable or if it could potentially become friable as part of the repair, renovation, removal, containment, or disposal process, such costs should be included in the estimate of asbestos-related cleanup costs.”

Appendix B: Illustrations -- Examples of Practice

The examples shown in this appendix are for illustrative purposes only. The explanations and illustrations are presented to show how the standards may be applied but are not standards themselves. These illustrations are general in nature and may not apply to specific cases that appear similar but have unique circumstances.

The following examples illustrate the estimation of asbestos-related clean up costs associated with future repair/renovation or demolition projects at the time the asset is placed in service

I. Evaluating Asbestos Cleanup Costs Associated with Real Property Repair or Renovation:

A federal entity recognizes the potential to repair or renovate real property during the course of its operating life. For real property containing asbestos, the asbestos plan states that measures must be taken to contain and properly dispose of the asbestos if the materials become damaged or need to be removed.

a. When the asset is placed into service or the entity first reports asbestos cleanup costs for a given real property, the following considerations may apply:

- An asbestos survey performed on the real property that requires repair indicates that the blown-in attic insulation and the ceiling tiles contain asbestos.
- A review of the federal and state requirements indicate that regardless of renovation or demolition method, the attic insulation and ceiling tiles will likely require removal in accordance with asbestos regulations.
- There is cost information available for removing, containing, and disposing of similar asbestos-containing materials.

b. Based on the information above and in accordance with TR 2, since asbestos containing materials are present, the probability requirement of recognizing a cleanup liability is satisfied. Also, since there is information about the cost of removal, containment and disposal of the asbestos, the cost associated with asbestos cleanup is reasonably estimable. The federal entity must estimate the asbestos-related cleanup costs to be incurred while conducting the repair or renovation, plus the cost of cleaning up the asbestos remaining in the real property at the time of demolition, where reasonably estimable. These estimated costs would then be recognized as a liability according to the guidance in SFFAS 6, paragraph 104.

II. Evaluating Asbestos Cleanup Costs Associated with Real Property Demolition:

A federal entity acquires an asset that is suspected to contain asbestos. Federal accounting standards require that federal entities estimate the liability associated with asbestos removal, containment, or disposal when the asset is placed in service.

a. At the acquisition date, the following is determined:

- There is no evidence or certification that the asset is asbestos-free. As some construction material utilized at the time the asset was built had been found to contain asbestos, it is therefore probable that asbestos may be present in the real property being assessed;
- The condition of materials suspected to contain asbestos was not surveyed by the previous owner;
- No asbestos survey or other assessment has been performed to estimate the type, location, or extent of asbestos in the real property;
- There are no assets that are similar in size, age and functionality that could be used to obtain information about the type, location, or extent of asbestos in the similar assets;
- There are no current reliable factors or parameters to be applied to a relevant asbestos liability estimation model; and

- It is not possible to determine the extent of the existence of asbestos without destroying or weakening the existing structure or disturbing potential asbestos, which would be undesirable.

b. Based on the information above and in accordance with TR 2, the presence of asbestos in the real property satisfies the probability requirement of liability recognition. However, the cost of removal, containment, and disposal of the asbestos is not reasonably estimable at this time. The existence of asbestos and a statement that such an estimate cannot be made should be disclosed. In this case, the federal entity must estimate a liability for conducting an asbestos survey and any other identifiable associated cost, recognize that liability in accordance with the guidance in SFFAS 6, paragraph 104, and disclose information about the real property in the notes to the financial statement. Also, as relevant information about the real property and its asbestos become available, the federal entity should reconsider its key assumptions and use an acceptable estimation technique (i.e., cost model or similar real property) to develop a reasonable estimate of asbestos cleanup costs.

Technical Release 11: Implementation Guidance on Cleanup Costs Associated with Equipment

Status

Issued	June 2, 2010
Effective Date	Upon issuance
Affects	None.
Affected by	None.

Summary

This technical release is intended to address cleanup costs associated with equipment as it applies to SFFAS 1, 5, 6 and TR 2. The guide focuses on cleanup of hazardous waste associated with equipment. It focuses on when cleanup costs should be recognized as an environmental liability and when it should be expensed as a cost of routine operation. In addition the guide includes two examples – one example is associated with equipment cleanup when a liability should be recognized and one is associated with equipment cleanup when the costs should be expensed as routine operations. This technical release provides steps that can be followed to help federal entities consistently apply existing standards. The guidance will also assist federal entities to provide reasonable estimates of cleanup costs associated with the disposal of equipment assets, when required.

Table of Contents

Introduction

Purpose

1. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) 6 (paragraphs 97 and 98), cleanup costs that occur when operations cease shall be estimated when the associated asset is placed in service and a portion of estimated total cleanup costs shall be recognized as expense during each period that the asset is in operation. The purpose of this technical release is to provide implementation guidance on cleanup costs associated with equipment.[1] This technical release clarifies the accounting for cleanup costs associated with permanent or temporary closures, or shutdown of equipment[2] (i.e., when cleanup cannot occur until the end of the useful life or at regular intervals during that life). This technical release also clarifies the accounting for other cleanup costs associated with ongoing operations (i.e., "routine"[3] hazardous waste removal and disposal) as outlined in SFFAS 6 paragraph 93. Cost for hazardous waste that is cleaned up and managed routinely is accounted for in accordance with SFFAS 6 paragraph 93 and the accounts payable provisions of the liability standards in SFFAS 1.[4]

Scope

2. The guidance in this technical release relates to cleanup costs associated with equipment as defined by SFFAS 6 par. 85 - 87.

3. Readers of this technical release should first refer to the hierarchy of accounting standards in SFFAS 34. 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 clarifies, but does not change, guidance previously provided in Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*; SFFAS 5 *Accounting for Liabilities of the Federal Government*, SFFAS 6 *Accounting for*

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[1] Equipment is defined in Appendix D.

[2] SFFAS 6 Par. 87: Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post closure costs.

[3] See definition in Appendix D.

[4] SFFAS 1 paragraph 74: Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities.

Property, Plant, and Equipment, Chapter 4: Cleanup Costs; and Technical Release (TR) 2 *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government.*

Effective Date

4. This technical release is effective immediately.

Background

Overview

5. SFFAS 6 Chapter 4: *Cleanup Costs* applies only to cleanup costs from federal operations known to result in hazardous waste which the federal government is required to cleanup by federal, state and/or local statutes and/or regulations that have been approved as of the balance sheet date, regardless of the effective date of such statutes or regulations (i.e., remove, contain or dispose of). These cleanup costs meet the definition of liability provided in SFFAS 5.[5] Due to the nature of the environmental liability and the timing associated with cleanup costs, additional guidance is provided in SFFAS 6 on the recognition of cleanup costs over the life of the related equipment. The SFFAS 6 guidance is required since cleanup generally does not occur until the end of the useful life of the equipment or at regular intervals during that life. Other cleanup costs, such as those resulting from accidents or where cleanup is an ongoing part of operations, are to be accounted for in accordance with the liability standards (i.e., SFFAS 1 and SFFAS 5) and are not subject to the recognition guidance provided in SFFAS 6, since the cleanup effort is not deferred until operation of associated equipment ceases either permanently or temporarily.

6. This technical release provides steps that can be followed to help federal entities consistently apply existing standards and ensure consistent, accurate and meaningful application of the standards. The guidance will also assist federal entities to provide reasonable estimates of cleanup costs associated with the disposal of equipment, when

[5]SFFAS 6, paragraph 88: This standard applies only to cleanup costs from Federal operations known to result in hazardous waste which the Federal Government is required by Federal, state and/or local statutes and/or regulations that have been approved as of the balance sheet date, regardless of the effective date, to cleanup (i.e., remove, contain or dispose of). These cleanup costs meet the definition of liability provided in *SFFAS 5 [Statement of Recommended Accounting Standards no. 5, Accounting for Liabilities of the Federal Government (SRAS no. 5)]*.

required. The identification and recognition of an environmental liability associated with equipment being decommissioned/ disposed is illustrated in Diagram 1.

Related Accounting Literature

7. The related accounting standards are as follows:

Federal Accounting Standards Advisory Board (FASAB) Accounting Standards:

a. SFFAS 1, *Accounting for Selected Assets and Liabilities*

b. SFFAS 5, *Accounting for Liabilities of the Federal Government*

c. SFFAS 6, *Accounting for Property, Plant, and Equipment*

d. Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*

Technical Guidance

Cleanup Costs Associated with Equipment at Disposal

8. In accordance with SFFAS 6, the cleanup costs are the costs of removing, containing, and disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste[6] at permanent or temporary shutdown of the associated equipment asset. If the hazardous waste cleanup is unique to the equipment closure (either temporarily or permanently), disposal, or decommissioning, then the cleanup costs, as defined above, shall be estimated when the associated equipment asset is placed in service. Recognition of the expense and accumulation of the environmental liability shall begin on the date that the equipment asset is placed into service, continue in each period that operation continues, and be completed when the equipment asset ceases operation.[7] A portion of estimated total cleanup costs shall be recognized as expense during each period that the equipment is in operation.[8] [9] In accordance with SFFAS 5, the liability is recognized when a future outflow or other sacrifice of resources as a result of past transactions or events is probable and reasonably estimable. In addition, TR 2 outlines several key factors (tests) that must be considered in determining whether a future outflow of resources from a federal entity for environmental cleanup is probable and can be reasonably estimable.

    <u>Example of Practice -- Cleanup Costs Associated with Equipment at Disposal:</u>

    Determination of hazardous waste cleanup liability associated with equipment disposal at the time equipment is being placed in service.

[6]SFFAS 6 paragraph 86: Hazardous waste is 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.

[7] SFFAS 6 paragraph 98: Recognition of the expense and accumulation of the liability shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation.

[8] SFFAS 6 paragraph 97: A portion of estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E (e.g., expected usable landfill area) whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as the basis for systematic and rational recognition of expense and accumulation of the liability.

[9] SFFAS 6 paragraph 104 provides additional instructions for initial implementation of SFFAS 6 and for liabilities related to assets in service at the effective date of this standard.

9. As the entity assesses the probability of future outflows of resources for environmental cleanup associated with the equipment disposal, the following factor should be considered. Does the acquisition or any other relevant information (e.g. operating records, experience with similar assets, etc.) identify materials that are used or created within the process that would constitute a hazardous waste at disposal? If the future outflows of resources for environmental cleanup are not probable, then the criterion for recognition of a liability is not established.[10]

10. If the future outflows of resources for environmental cleanup are probable then the entity must assess whether the hazardous waste associated with the newly acquired equipment will be regulated and/or managed the same as other routine operational waste (i.e. routinely disposed using the same method) at the federal facility, or will it be uniquely managed.

11. As the entity assesses the reasonable estimability of future outflows of resources for environmental cleanup related to equipment disposal, the entity should consider whether liability can be estimated for removing, containing, and/or disposing of the hazardous waste.[11]

12. If the future outflow of resources for environmental cleanup related to the equipment disposal are probable, and it is determined that the hazardous waste associated with the newly acquired equipment is **not** routinely removed and disposed during equipment operation; and the costs of removal or containment and/or disposal of the hazardous waste associated with disposal of the equipment can be reasonably estimated (estimates may include a study, if required), then the requirement of equipment disposal cleanup liability recognition has been satisfied and the federal entity must recognize an environmental liability for these estimated costs in accordance with SFFAS 6, paragraph 98. (See illustration in Diagram 1.)[12]

[10] Technical Release 2 establishes guidance for when costs associated with environmental damage meet the probable and reasonably estimable criteria.

[11] SFFAS 6 Note 68: The unit of analysis for estimating liabilities can vary based on the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, an estimate of the cleanup costs could be made on a facility by facility basis, or an entity by entity basis.

[12] In accordance with SFFAS 6, paragraph 96, “Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.” As additional information becomes available, the agencies must re-evaluate assumptions, revise cost estimates, and make necessary adjustments to the liability recognition.

Cleanup Costs Associated with Equipment during Ongoing Operations

13. In accordance with SFFAS 6, paragraph 93,[13] if such cleanup is an ongoing part of operations, the costs are to be accounted for in accordance with liability standards outlined in SFFAS 1 and are not subject to the recognition guidance provided in SFFAS 6, chapter 4 (paragraphs 97 and 98). Any accrued liability/payable and associated operating expense should be recognized in the period the cleanup occurs as part of ongoing operations.

14. In many cases, hazardous wastes removed and disposed at decommissioning, shutdown and/or disposal of equipment are the same as those managed as part of the periodic routine maintenance and day-to-day operations, as determined by the regulatory requirements and method of managing the waste. For instance, the costs of removing and disposing of hazardous waste (e.g., batteries, cleaning solvents, motor oil) incurred as part of periodic routine maintenance of equipment over its useful life, are generally expensed and the associated liability/payable is recognized as the costs are incurred. The cost of removing and disposing of the same routine maintenance hazardous waste at the time of equipment disposal would likewise be expensed and associated liability is recognized when incurred.

<u>Example of Practice -- Cleanup Costs Associated with Equipment during Ongoing Operations:</u>
Determination of hazardous waste cleanup during ongoing operations of the equipment (routine hazardous waste disposal) at the time the equipment is being placed in service.

15. As the entity assesses the probability of future outflows of resources for environmental cleanup related to the equipment, the following factor should be considered. Does the acquisition or any other relevant information (e.g. operating records, experience with similar assets, etc.) identify materials that are used or created within the process that would constitute a hazardous waste at disposal? If the probability of future outflows of resources for environmental cleanup is not met, then the criterion for recognition of a liability is not established.[14]

16. If the future outflows of resources for environmental cleanup are probable, then the entity must assess whether the hazardous waste associated with the newly acquired equipment will be regulated and/or managed the same as other routine operational waste at the federal facility or will it be uniquely managed.

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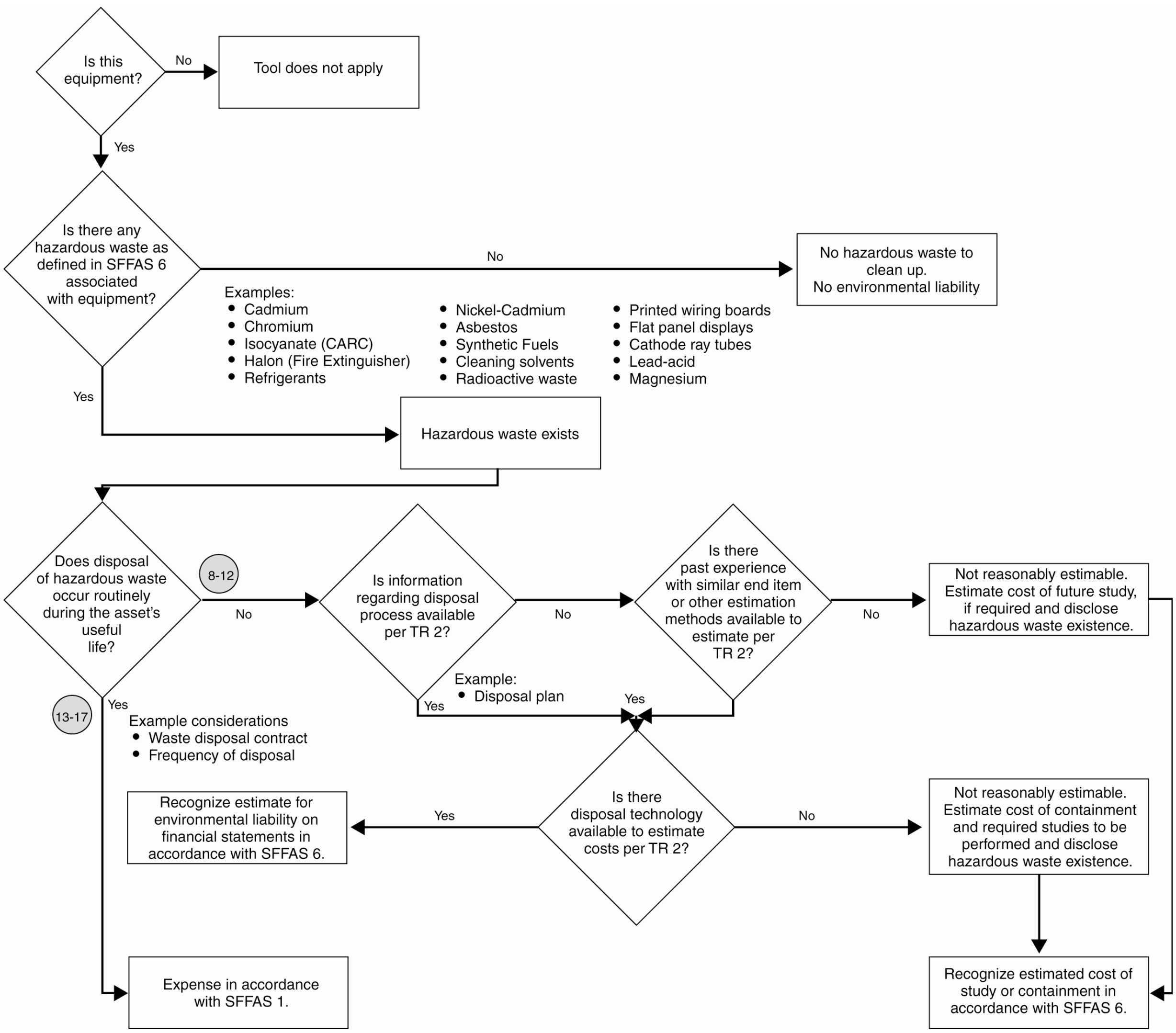
[13] SFFAS 6 paragraph 93: Other cleanup costs, such as those resulting from accidents or where cleanup is an ongoing part of operations, are to be accounted for in accordance with liability standards and are not subject to the recognition guidance provided in this standard. This guidance does not apply to these other types of cleanup since the cleanup effort is not deferred until operation of associated PP&E ceases either permanently or temporarily.

[14] Technical Release 2 establishes guidance for when costs associated with environmental damage meet the probable and reasonably estimable criteria.

17. If the future outflows of resources for environmental cleanup related to the equipment disposal are probable and it is determined that the hazardous waste associated with the newly acquired equipment is regulated and/or managed the same as other routine operational wastes, then the costs of removal, containment and/or disposal of the routine wastes associated with disposal of this equipment asset are to be recognized, in accordance with the liability standards, in the period that the removal, containment and/or disposal of routine wastes occurs. These costs are **not** subject to the recognition guidance provided in SFFAS 6, paragraph 98. (See illustration in Diagram 1 below.)

Diagram 1: Recognizing Environmental Liabilities for Equipment Disposal in Compliance with Technical Release 2 and SFFAS 1, 5 and 6

(Circles correlate to Sections of document)



The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

A1. In January 2008, the Accounting and Audit Policy Committee (AAPC) established the General Property, Plant, & Equipment (G-PP&E) task force to assist in developing implementation guidance for federal G-PP&E as it relates to SFFAS 6, *Accounting for PP&E, SFFAS 23, Eliminating the Category National Defense Property Plant, & Equipment,* and other related G-PP&E guidance developed by the FASAB. The task force includes federal agency representatives who are experiencing G-PP&E implementation issues and those who have G-PP&E implementation best practices to share with the federal community.

A2. The G-PP&E task force was divided into four subgroups that will address a set of related issues. The subgroups meet separately on a regular basis to discuss their set of issues and report back to the full task force on its progress towards the development of implementation guidance. The four sub-groups are

- G-PP&E Acquisition
- G-PP&E Use
- G-PP&E Disposal
- G-PP&E Records Retention

A3. This guidance was developed by the Disposal subgroup. The subgroup included members from the following federal agencies:

- Department of Defense
- Department of Energy
- Department of the Interior
- Government Accountability Office
- General Services Administration
- National Aeronautics and Space Administration

The subgroup included accountants, program managers, and functional PP&E experts. The program managers gave the subgroup the perspective of how the standards come into play on a day-to-day basis.

A4. The scope of the implementation guidance is to address cleanup costs associated with equipment as it applies to SFFAS 1, 5, 6 and TR 2. The technical release focuses on when to recognize clean-up of hazardous waste associated with equipment as an environmental liability and when to expense as a routine operational cost. The technical release is separated into two sections – one addressing when SFFAS 1 should be applied and the other when SFFAS 6 should be applied. In addition, the technical release includes two examples – one example is associated with hazardous waste cleanup not routinely managed and disposed of, which includes liability recognition (e.g., PCB removal and disposal during ship decommissioning) and the other example is associated with hazardous waste cleanup routinely managed and disposed of, which includes expensing of the costs being accounted for as an operational expense (e.g., removal of dry cleaning solvents).

A5. This technical release provides steps that can be followed to help federal entities consistently apply existing standards to assist in providing consistent, accurate and meaningful information.

A6. In January 2009 the Disposal subgroup of the G-PP&E task force presented a draft equipment cleanup issue paper to the AAPC for review. The committee asked the subgroup to better clarify when the equipment cleanup cost should be recognized as a liability and when the costs should be expensed as routine operations. The Committee also asked the subgroup to include an additional example in the technical release for a naval ship to show the distinction between the disposal of hazardous waste during the normal operations of the ship and the disposal of hazardous waste unique to decommissioning the ship. In May the subgroup returned to the AAPC with a revised version of the implementation guidance that included the requested clarifications as well as the ship example. The members provided some additional comments to the subgroup on the technical release and agreed to review a pre-ballot exposure draft of the guidance before the July AAPC meeting and then have a ballot exposure draft available at the July meeting.

A7. The AAPC released the exposure draft (ED), *Implementation Guidance on Cleanup Costs Associated with Equipment* on September 3, 2009. 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 committees of professional associations commenting on past exposure drafts.

A8. Ten letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors		
Preparers and financial managers	8	

A9. AAPC received a comment on the exposure draft requesting clarification on financial transactions and reporting requirements for cleanup costs associated with permanent versus temporary shutdown of the asset. Further, the respondent requested the exposure draft to be changed to only report cleanup costs associated with permanent shutdown of equipment. SFFAS 6 paragraph 85[15] requires reporting of cleanup costs associated with both temporary and permanent shutdown of assets. In addition, the AAPC G-PP&E, Disposal Sub-group is in the process of defining triggering events and associated financial transactions for permanent and temporary shutdown and/or closure of G-PP&E. Additional guidance related to financial transactions and accounting for cleanup costs at the time the asset is permanently and/or temporarily closed and/or shutdown will be provided as a result of that effort.

[15] Cleanup costs are 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.

Appendix B: Illustrations

The examples shown in this appendix are for illustrative purposes only. The explanations and illustrations are presented to show how the standards may be applied but are not standards themselves. These illustrations are general in nature and may not apply to specific cases that appear similar but have unique circumstances.

Example 1: Decommissioning of Used Perchloroethylene Dry Cleaning Equipment

A dry cleaning operation uses the hazardous material perchloroethylene (perc). Perc is a colorless liquid with mild odor used primarily as a dry cleaning solvent. Perc is highly volatile; 80-85% of the chemical used annually is released into the atmosphere with only 1% to water. The greatest health risk presented by perc is inhalation by industry workers. Studies of industry workers indicate a "probable" linkage between prolonged exposure and certain cancers.

Drycleaners typically recycle used solvent on-site which creates several hazardous wastes. Although the quantities of waste have been greatly reduced through recycling, hazardous waste will continue to be removed and disposed as long as the hazardous solvent is used in the operation. In addition, leaks and spills represent a significant potential environmental hazard.

Table 1 presents the hazardous waste removed and disposed of from dry cleaning operations throughout the life of the asset and at decommissioning. The second and third columns of the table list the regulatory categorization (i.e., EPA Hazardous Waste code), and method for managing the waste, respectively. The fourth column indicates if the hazardous waste is regulated and managed in a manner that is routine to the operations or unique to decommissioning and disposing of the equipment at the end of its useful life.

Table 1. Hazardous Waste from Dry Cleaning Operations and Decommissioning

Waste	EPA HW Code	Waste Management Method	Routine/ Unique	Accounting Practice	Rationale
Spent Solvent	F002[1], D039[2]	Reuse/recycle on-site or Ship to TSDF[3]	Routine	Operational expense (SFFAS 1)	Reuse/recycle exempts waste or same waste/mgmt as operational
Used Filter Cartridges	F002, D039	Ship to TSDF	Routine	Operational expense (SFFAS 1)	Same waste/mgmt as operational
Distillation Residues	F002, D039	Ship to TSDF	Routine	Operational expense (SFFAS 1)	Same waste/mgmt as operational
Cooked Powder Residues	F002, D039	Ship to TSDF	Routine	Operational expense (SFFAS 1)	Same waste/mgmt as operational
Unused Perc	D039	Reuse/recycle on-site or return to distributor	Routine	Operational expense (SFFAS 1)	Reuse/recycle exempts waste
Wastewater from equipment cleaning	F002, D039	Ship to TSDF	Routine	Operational expense (SFFAS 1)	Same waste/mgmt as operational

Key:

[1]F002: Represents waste containing the class of solvent that includes perchloroethylene.

[2]D039: Represents waste containing the specific solvent, perchloroethylene.

[3]TSDF: Facility permitted for Treatment, Storage, and Disposal of RCRA hazardous waste.

All hazardous waste from this equipment falls under the same regulatory requirements (F002, D039) and waste management method (ship to TSDF), or it is recycled and not disposed as a hazardous waste. The hazardous waste removed at decommissioning is the same as waste from ongoing operations and managed the same, as determined by the regulatory requirements. Thus, the cost associated with removal and disposal of the waste produced at decommissioning is recognized as a liability/payable and operational expense in the period incurred in accordance with the guidance provided in SFFAS 6, paragraph 93 and SFFAS 1.

References:

1. RCRA in Focus: Dry Cleaning, EPA530-K-99-005, June, 1999.

2. Proper Disposal of Used Perc Dry cleaning Equipment, Environmental Facilities Corp, April, 2002.

3. A Pollution Prevention Guide for the Dry Cleaning Industry, Delaware Department of Natural Resources and Environmental Control, www.dnrec.state.de.us/deldrycl.htm

Example 2: Ship Disposal

The disposal of ships belonging to federal agencies is a significant event within asset lifecycle management. Extensive planning and acquisition of services is required to prepare for the retirement of these large-scale assets. Ship disposal may occupy 6 months to 1 year scheduling time of the shipyard's drydock space. Removal of hazardous materials from the ship requires careful planning since the presence of water in and around the ship provides a transport media for hazardous materials to the environment and for human exposure.

In the late 1990's, the U.S. Navy conducted a pilot study to evaluate the feasibility and cost associated with retiring ships, focusing on processes and costs for hazardous material removal. Four separate contractors performed complete ship disposal, using customized processes and in accordance with the environmental regulatory standards of their respective States.

Tables 2 and 3 present the waste streams managed during the disposal operation and identify whether the waste regulation and management is operationally routine or unique to the disposal process. The fifth column indicates if the costs should be accrued as a liability over the life of the asset (i.e., estimated at the time the asset is placed into service and recognized over the life of the asset) in accordance with SFFAS 6, paragraph 98, or expensed and recorded as a payable when the cost is incurred in accordance with SFFAS 1. The tables present high and low volume wastes, respectively, based on the experience of the contractors from the study.

Table 2. High Volume/Cost Waste Streams

Waste	Source of Waste	Waste Management Method	Routine/ Unique	Accounting Practice	Rationale
Asbestos-containing materials (ACM)	Pipe and hull insulation and cloth, liner, mastic, plastic foam, gaskets	Disposal in ACM approved landfill[16]	Unique	Accrued Liability (SFFAS 6, paragraph 98)	Unique operation and disposal of regulated waste.
PCB Containing Waste	Cable coatings, felt backing, paint, rubber products	PCB removal under TSCA; Disposal as Solid or TSCA regulated waste.[17]	Unique	Accrued Liability(SFFAS 6, paragraph 98)	Unique operation and disposal; TSCA[18] requires PCB removal from metal prior to further processing.
Waste Oil (Petroleum products)	Fuel, lube oil, hydraulic oil	Recover and recycle.	Routine	Operational Expense (SFFAS 1)	Recovery of useful materials (e.g., metal, fuel) is not a liability.

[16]One contractor disposed electrical cables with asbestos-containing sheathings in their entirety, thereby greatly increasing the volume of ACM waste. Others removed the sheathings to recycle the copper cables. Also, some managed all thermal insulation as ACM rather than sample to determine exact amounts.

[17]Contractors in States that did not adopt EPA's PCB "Mega Rule" need to sample and dispose all PCB waste as TSCA regulated waste. Other States that did adopt the rule allow disposal of PCB Bulk Product Waste (BPW) in a (non-hazardous) Solid Waste Landfill.

[18]Toxic Substance Control Act (TSCA) effective 1/1/77 authorizes EPA to control any substance that was determined to cause unreasonable risk to public health or the environment.

Table 3. Low Volume/Cost Waste Streams

Waste	Source of Waste	Waste Management Method	Routine/ Unique	Accounting Practice	Rationale
Mercury	Fluorescent light tubes, fire detectors, tank level indicators	Universal waste recycling.	Routine	Operational Expense (SFFAS 1)	Routine recycling.
RCRA-hazardous paint coatings on metal	Ship transducers, ballast, paint coatings	Transferred to scrap metals recycler, RCRA exempt.	Routine	Operational Expense (SFFAS 1)	Routine recycling of useful materials.
Equipment with RCRA-hazardous materials	Contained in equipment	Sale and reuse with disclosure to buyers	Routine	Operational Expense (SFFAS 1)	Recovery of useful materials (e.g., metal, fuel) is not liability.
CFCs	Small refrigerators, water coolers, small freezer units	Sale or reuse; CFC recycled by authorized subcontractor.	Routine	Operational Expense (SFFAS 1)	Routine recycling.

Note to Tables 2 & 3:

Estimated costs associated with two of the high volume wastes (i.e., PCB and asbestos-containing wastes) from ship decommissioning and disposal should be accrued as a financial liability over the asset's useful life as they are non-routine wastes not otherwise managed over the life of the asset. Costs associated with the remainder of the wastes would be accounted for as operational expense in the period incurred in accordance with the guidance provided in SFFAS 6, paragraph 93 and SFFAS 1. These wastes are either routinely recycled materials due to their inherent value (e.g., fuel, oil, CFCs), sold, or routinely disposed as universal waste (e.g., fluorescent lights, batteries, gauges).

However, as stated upfront in this example, ship decommissioning is a unique operation due to increased risk and need for specialized services and space. In addition, the environmental costs incurred by individual contractors vary due to factors such as State and local regulation, technical approach to ship disposal, and waste identification and management processes. As a result, the federal agency's management will likely need to make environmental liability determinations based on planned disposal operations for the asset or group of assets, using the examples provided in this document as a guide.

Appendix C: Abbreviations

ACM	Asbestos Containing Material
CARC	Chemical Agent Resistant Coating
CFC	Chlorofluorocarbon
PCB	Polychlorinated biphenyl
PERC	Perchloroethylene
RCRA	Resource Conservation and Recovery Act
TSCA	Toxic Substances Control Act
TSDF	Treatment Storage Disposal Facility

Appendix D: Glossary

Environmental Liability

An environmental liability is a probable, measurable and reasonably estimable future outflow or expenditure of resources that exist as of the financial reporting date for environmental cleanup costs resulting from past transactions or events.

Equipment

Equipment is any tangible, nonexpendable, personal property having a useful life of more than one year and an acquisition cost of $5,000 or more per unit. (34 CFR 80.3).

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. (FASAB Consolidated Glossary 2009).

Reasonably Estimable

The ability to reliably quantify in monetary terms the outflow of resources that will be required. (TR 2)

Routine Hazardous Waste Disposal

Disposal of hazardous waste that is regulated and managed the same as hazardous waste disposed of from day-to-day operations and on a regular basis.

Useful Life

The normal operating life in terms of utility to the owner. (FASAB Consolidated Glossary 2009)

Technical Release 12: Accrual Estimates for Grant Programs

Status

Issued	August 4, 2010
Effective Date	For fiscal periods beginning after September 30, 2010.
Affects	None.
Affected by	None.

Summary

This technical release addresses materiality considerations, risk assessment, and procedures for estimating accruals for grant programs, including acceptable procedures until sufficient relevant and reliable historical data is available for new grant programs or changes to existing programs. This technical release also provides guidance on acceptable sources of documentation for grant accrual estimates; internal controls, including monitoring of internal controls and validation of grant accrual estimates; training of grantees; and monitoring of grantee reporting.

Table of Contents

Introduction

Purpose

1. A series of roundtables in April 2009 indicated that guidance for estimating accruals for grant programs would be helpful for agencies. Specifically, agencies indicated a need for guidance that describes a cost-effective framework for developing reasonable estimates of accrued grant liabilities.

Scope

2. This Technical Release (TR) applies to **grants**[1] that are paid by a federal entity to a non-federal entity. This TR does not apply to contracts or other purchases of goods or services. This TR does not establish new reporting requirements. This TR does not affect reporting in the Budget of the United States or special-purpose reports such as those required by law or regulation to be prepared in accordance with guidance other than generally accepted accounting principles.

Effective Date

3. This technical release is effective for periods beginning after September 30, 2010, with earlier implementation encouraged.

[1] Terms first appearing in **bold** are defined in the glossary.

Background

Overview

4. This TR addresses materiality considerations, risk assessment, and procedures for estimating accruals[2] for grant programs, including acceptable procedures until sufficient relevant and reliable historical data is available for new grant programs or changes to existing programs. This TR also provides guidance on acceptable sources of documentation for grant accrual estimates; internal controls, including monitoring of internal controls and validation of grant accrual estimates; training of grantees; and monitoring of grantee reporting.

Related Accounting Literature

5. Related accounting standards are listed below. Relevant excerpts are provided in *Appendix C: Relevant Citations of Existing Guidance*.

    a. Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*,

    b. SFFAS 3, *Accounting for Inventory and Related Property*,

    c. SFFAS 5, *Accounting for Liabilities of the Federal Government*,

    d. SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*

    e. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definition of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*

[2] Agencies must recognize and report balances due to or advanced to grantees at the end of the reporting period. Adjustments are needed to provide for eligible expenses that grantees have incurred as of the reporting date but have not yet reported to the agencies. Since these adjustments are based upon estimates, they are referred to as “accrual estimates” in this guidance. In particular:

- Advances: Amounts issued as advances must be adjusted, even if grantees have not yet reported expenses incurred. (See SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-59.)
- Accounts Payable: Where there is no advance or no remaining advance, agencies must estimate amounts payable to grantees. (See SFFAS 5, *Accounting for Liabilities of the Federal Government*, par. 24-25.)

Technical Guidance

Definitions

6. **Grants**: 31 USC Section 6304 defines grants as follows: An executive agency shall use a grant agreement as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when (1) the principal purpose of the relationship is to transfer a thing of value to the State or local government or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and (2) substantial involvement is not expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.[3]

Materiality Considerations and Risk Assessment

7. SFFAS 3, paragraph 14, states that "the accounting and reporting provisions of…standards should be applied to all items that would influence or change the users' judgment of the entity's efficiency and effectiveness and its compliance with laws and regulations in a material manner."[4] In particular, management should consider the materiality of the grant program relative to the agency's statement of net cost.

8. The following list includes some of the factors that management should consider in determining which grant programs may have a higher risk of material misstatement that might cause financial statement users to make incorrect assessments regarding the efficiency and effectiveness of the program:

   a. the degree of variance between past estimates and the program's actual operating cost (if applicable)

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[3] 31 USC Section 6302 excludes the following from the definition of a grant agreement: agreements under which is provided only -
(A) direct United States Government cash assistance to an individual;
(B) a subsidy;
(C) a loan;
(D) a loan guarantee; or
(E) insurance.

[4] SFFAS 3, paragraph 14. See Attachment 1 for the full discussion of materiality from SFFAS 3.

b. significant findings reported in past program audits (if applicable)

c. the age of the program (other factors being equal, mature programs may have less risk than newer programs)

d. Congressional and other public policy interest in a given program

9. For grant programs that are immaterial to the statement of net cost and/or that have a lower risk of misstatement, management might consider validating estimates less frequently.

10. Management should apply cost-benefit considerations to the process of estimating accruals for grant programs.

Preparing Accrual Estimates for Grant Programs

11. Preparing reliable and timely accrual estimates for grant programs must be a joint effort between the budget, financial, and program offices at each agency. These offices should work together to ensure that the procedures and internal control recommendations[5] outlined in this TR are implemented and operating as designed. However, some agencies may not be able to effectively implement all of these procedures, because they have not yet developed the necessary data stores and/or methods for preparing grant accrual estimates. Therefore, until sufficient relevant historical information on grant programs is available, the alternatives outlined in this TR should be utilized for developing grant accrual estimates.

12. Agencies should document and maintain support for the data and assumptions used to develop grant accrual estimates. The documentation will facilitate the agency's review of the assumptions, a key internal control, and will also facilitate the auditor's testing of the estimates. 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. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purpose of reconstructing the estimates.

[5] 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 communications and monitoring. Source: Summarized from *Internal Control Integrated Framework*, issued by the Committee of Sponsoring Organizations (COSO), consisting of the American Institute of CPAs (AICPA), the Institute of Management Accountants (IMA), the Institute of Internal Auditors (IIA), Financial Executives International (FEI), and the American Accounting Association (AAA). See http://www.aicpa.org/audcommctr/toolkitsnpo/Internal_Control.htm (accessed 3-12-2010)

13. For both existing grant programs and new or modified grant programs, management's documentation of relevant program design factors may include:

    a. program definition including legislation

    b. legislation or regulations changing the terms, maximum grant amount, total program size, or characteristics of the grantee population

    c. program eligibility requirements

    d. grant agreements detailing the terms and conditions of the grants

Preparing Accrual Estimates for Existing (Mature) Grant Programs

14. Agencies must accumulate sufficient relevant and reliable data on which to base accrual estimates. Each agency should prepare grant accrual estimates based upon the best available data at the time the estimates are made. Guidance on the types of supporting documentation of procedures that are acceptable for existing (mature) grant programs is found in paragraphs 13 and15 of this document.

15. For existing programs, management should ensure that adequate documentation is available for accrual estimates relating to existing grant programs. Typical support documentation may include:

    a. procedures used for calculating the estimate

    b. documentation for the review and approval process for the estimate

    c. support for the calculation of the estimate, including the underlying assumptions used

    d. historical data supporting the assumptions

    e. relevant documentation of supporting actual cash and/or accrual experience (including the date and source of reports, whether grantees reported on a cash or accrual basis, and how recently the data were updated). The documentation may include:

        i. historical data and trends, citing sources of information and relevant time frame

        ii. an analysis that identifies the most critical factors

        iii. trend analysis developed from reports from the accounting or program management systems

iv. evidence of experience by other agencies with similar programs

v. evidence of emergencies or legislated changes, such as changes in program terms, program size, or characteristics of grant recipients

vi. evidence of other relevant factors that may be identified by grant program managers

f. explanation of any sampling process used, including, if applicable, treatment of grant programs with different payment patterns, and/or legislation

g. explanation of the calculation concept used, such as simple linear regression, statistical analysis, or other appropriate method

h. procedures for error checking, including procedures to validate the completeness and accuracy of the underlying data used in preparing the accrual estimate

i. procedures for monitoring/validation subsequent to the end of the reporting period

Preparing Accrual Estimates for New Grant Programs or Changes to Existing Grant Programs

16. In the absence of sufficient relevant and reliable historical data on which to base accrual estimates, agencies should prepare estimates based upon the best available data at the time the estimates are made. Paragraphs 13 and 19 of this document provide guidance on acceptable types of supporting documentation.

17. In certain limited instances, informed opinion may be used to support grant accrual estimates in the absence of sufficient relevant and reliable historical data. Informed opinion refers to the judgment of agency staff or others who make 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 and reliable historical data and/or modeling capabilities are not available. This could occur when a new program has been established or when the 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.

18. If an expert is used, the expert's qualifications, such as professional or academic certification or length and kind of experience, must be assessed. The basis of the stated opinion must be articulated and documented in sufficient detail to allow review and

validation by independent sources, including independent auditors. For example, a statistician may be best qualified to determine the appropriate model for grant accrual estimates using limited or imperfect data.

19. Management should ensure that adequate documentation is available for grant accrual procedures for new programs or changes to existing programs that do not have historical supporting documentation. In the absence of relevant and reliable historical experience as the support for estimates, the agency should document the basis for accrual estimates. Typical support may include:

    a. relevant experience from other programs within the reporting agency or programs at 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 new programs or changes to existing programs of the agency relying on the experience of the other agency

    b. extrapolation from subsets of prior program activity, e.g., while prior grants were not specifically targeted to a certain pool of grantees, it may be possible to identify prior activity with grantees with the same or similar characteristics to the targeted pool

    c. information from program managers regarding grantee activity and spending patterns

20. When expert opinion is used as an interim measure, the agency should document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis for the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:

    i. reports and studies on relevant issues

    ii. minutes from internal meetings and other relevant communications describing the basis for any assumptions or changes in assumptions

21. An illustrative decision tree diagram of the grant accrual process is displayed in Figure 1 of *Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals*.

Internal Controls: Developing Grant Accrual Estimates

22. Management should ensure that adequate internal control procedures are in place. Procedures in place should ensure that grant accrual estimates are based on historical transactions in previous years to the extent that relevant and reliable historical data exists.

23. Documented procedures are important to communicate relevant information on the grant accrual estimation to employees and management as well as other interested parties, such as auditors. As an agency experiences employee turnover, these documented procedures can provide vital information for new employees on how to complete reliable, well supported grant accrual estimates. Such documentation may be used to establish consistent procedures for developing grant accrual estimates across grant programs with similar characteristics.

24. Internal control documentation may include:

a. documentation of the procedures and flow of information used in developing grant accrual estimates, e.g., flow chart with supporting narrative

b. a discussion of who is responsible for each step of the estimate as well as the review and approval process followed

c. the model(s) used, the rationale for selecting the specific methodologies, and, for programs with sufficient historical data, the degree of calibration within the projected spending model(s)[6]

d. the sources of information, the logic flow, and the mechanics of the model(s), including the formulas and other mathematical functions

e. detailed subsidiary accounting records by grant program

f. an audit trail from individual transactions to the subsidiary ledgers to the general ledger

g. an assessment of the impact of changes in law or regulations on the reliability of estimates and should ensure that the grant accrual estimate model reflects these changes

h. an assessment of the impact of subsequent events on the entity's grant accrual estimates (Some subsequent events may require adjustments to the financial

[6] Calibration is the degree of precision within the model, i.e., the model's ability to accurately predict the trends of expenses incurred for a given grant program. The degree of calibration within the model can be documented by charts or graphs showing projected expenses incurred versus the actual expenses incurred by reporting period. This document would analyze the variance between projected and actual expenses incurred by grantees.

statements while others may require disclosure in the notes to the financial statements.[7])

i. a trend analysis of grant accrual estimates from year to year, and results of investigations of unusual fluctuations that are identified

Monitoring Internal Controls

25. 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 controls performance over time. The Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal 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, efficiency and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on management controls. Circular A-123[8] provides that:

> Instead of considering internal control as an isolated management tool, agencies should integrate their efforts to meet the requirements of the FMFIA with other efforts to improve effectiveness and accountability. Thus, internal control should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and the integrity of every step of the process and provide continual feedback to management.
>
> Federal managers must carefully consider the appropriate balance between controls and risk in their programs and operations. Too many controls can result in inefficient and ineffective government; agency managers must ensure an appropriate balance between the strength of controls and the relative risk associated with particular programs and operations. The benefits of controls should outweigh the cost. Agencies should consider both qualitative and quantitative factors when analyzing costs against benefits.[9]

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[7] See requirements in SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, August 4, 2010.

[8] OMB Circulars are not applicable to legislative and judicial branch entities. However, the general principles are appropriate for federal reporting entities in the legislative and judicial branches.

[9] OMB Circular A-123, December 21, 2004, Section I, page 5.

Validation of Grant Accrual Estimates

26. As part of agencies' internal control procedures to ensure that grant accrual estimates for the basic financial statements were reasonable, agencies should validate grant accrual estimates by comparing the estimates with subsequent grantee reporting.

27. When subsequently validating the reasonableness of accrual estimates, an agency does not need to obtain data[10] from 100% of grantees in order to validate the reasonableness of grant accrual estimates. For example, agencies may validate estimates based upon:

    a. grantee data that represents a majority of the total grant portfolio, or

    b. data from a statistically valid sampling of the total grantee portfolio.

28. When developing grant accrual estimates, agencies only have access to data that is available at the time. The nature and reliability of available grant data varies widely and, because of the relationship between the grantor and the grantee, is often only indirectly influenced by management. The validation process includes an understanding that estimates are inherently uncertain, and that management must use judgment in determining:

    a. whether differences between estimated and actual expenses are reasonable

    b. if different estimation methods could result in more accurate estimates of net cost in the future

29. A difference between an accounting estimate and actual result does not necessarily represent a misstatement of the financial statements. Rather, differences could be an outcome of inherent estimation uncertainty. However, it could result in a misstatement if, as described in SFFAS 21, Reporting Corrections of Errors and Changes in Accounting Principles, the difference arises 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. Differences between estimates and actual should be taken into consideration in developing the subsequent period's estimate.[11]

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[10] Data refers to information provided by grantees regarding their actual expenses or expenditures. Sources of data may include, but are not limited to, grantee reports to agencies and audited amounts from Single Audit Act audits.

[11] See SFFAS 21, paragraph 10.

30. An illustrative decision tree diagram of the validation process is displayed in Figure 2 of *Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals*.

Training and Monitoring of Grantees

31. Since preparation of accrual estimates is dependent upon relevant and reliable data, accurate and timely reporting by grant recipients serves as the basis for historical data used in preparing future estimates and provides reliable actual data to which accrual estimates can be compared. Agencies should consider whether grant recipients need training on completing required financial reports. If needed, training may be delivered via agency sponsored conferences, workshops and/or seminars, customer service centers and help desks, or computer based sources such as webcasts or other training options available through the agency's website.

32. Reports submitted by grantees should be reviewed to ensure their reasonableness. Agencies should have policies and procedures in place to review and verify the grantee expenditures (or expenses) reported.[12]

33. When agencies engage in on-site financial monitoring of grantees, protocols should include comparing grant expenses or expenditures reported with actual expenses or expenditures and to supporting documentation. Techniques for monitoring of grantee reporting of expenditures may also include stratified sampling.

34. Timely follow up of incorrect reporting should be performed to ensure a higher degree of compliance with reporting requirements. For example, inaccurate grant expenditures (or expenses) reported could be conveyed to grantees by an official letter requesting a corrective action plan. During on-site financial reviews, technical assistance could be provided when grant expenditures reported are inaccurate.

The provisions of this Technical Release need not be applied to immaterial items.

[12] At the time of this writing, grant recipients predominantly report expenditures. However, expenses may be reported in some cases and in the future.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Committee members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Project History

A1. A series of roundtables in April 2009 indicated that guidance for determining whether estimates of advances and payables for grant programs are reasonable would be helpful for agencies. Specifically, agencies indicated a need for guidance supporting cost-effective development of reasonable estimates.

A2. A Task Force consisting of representatives from federal agencies and independent accounting and consulting firms assisted FASAB staff in identifying areas where guidance would be helpful. Specifically, members indicated a need for guidance regarding:

a. appropriate reliance on the best available data in light of the often limited access grantee data

b. situations where no historical data is available such as new or modified grant programs

c. assessment about materiality and whether it is appropriate to focus on the statement of net cost when making such assessments

d. cost-effective means of validating previous estimates

A3. Proposed draft guidance was submitted to the FASAB's Accounting and Auditing Policy Committee (AAPC) for consideration at the January 2010 AAPC meeting. The AAPC agreed to accept the project.

Summary of Outreach Efforts

A4. The exposure draft (ED), *Accrual Estimates for Grants,* was issued March 22, 2010, with comments requested by April 22, 2010. Upon release of the exposure draft, notices and press releases were provided to:

a. the Federal Register

b. FASAB News

c. the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, and Government Accounting and Auditing Update

d. the CFO Council, the Presidents Council on Integrity and Efficiency, and the Financial Statement Audit Network

e. committees of professional associations generally commenting on exposure drafts in the past

f. members of the Grants Accounting Task Force that helped develop the ED

A5. To encourage responses, a reminder notice was provided on April 22, 2010 to the FASAB Listserv.

Comments Received

A6. We received 24 responses from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others	0	3
Auditors	4	2
Preparers and financial managers	15	0
Total	19	5

A7. The majority of responses concurred with all aspects of the proposed guidance. Revisions were made for the following reasons:

a. corrections (such as removing references to year-end, since the guidance can be applied to any reporting period)

b. revisions to language that was more prescriptive than the AAPC intended (by adding phrases such as “typical support may include” rather than a list that might be interpreted as being a required checklist)

c. improvements for clarity and to improve the logical flow of the guidance

Netting of Grant-Related Advances and Accounts Payable

A8. The ED included the following proposed guidance on netting grant-related advances and accounts payable on the face of the balance sheet with a requirement to report grant-related advances and accounts payable in a note to the financial statements:

> **Display**
>
> [26] When grant accrual estimates are prepared on an aggregate level, agencies may display a net amount on the balance sheet and report estimated disaggregated advances and liabilities in a note. (An illustrative example is displayed in Appendix C, *Illustrative Example of Note on Netting Grant Advances and Accrued Liabilities*.)

A9. Although a majority of respondents concurred with the proposed guidance, a significant minority found the language confusing. In addition, the language appeared to allow netting in certain circumstances and to prohibit it in other circumstances, which was not the intent of the proposed TR. The AAPC believes that significant revisions to the guidance would be needed to clarify it. Generally, significant revisions are adopted only after providing an opportunity for public comment. Given the time involved in issuing a revised ED for comment, the AAPC decided to delete the proposed guidance on netting from this TR. The AAPC expressed willingness to address the issue of netting in the future if needed.

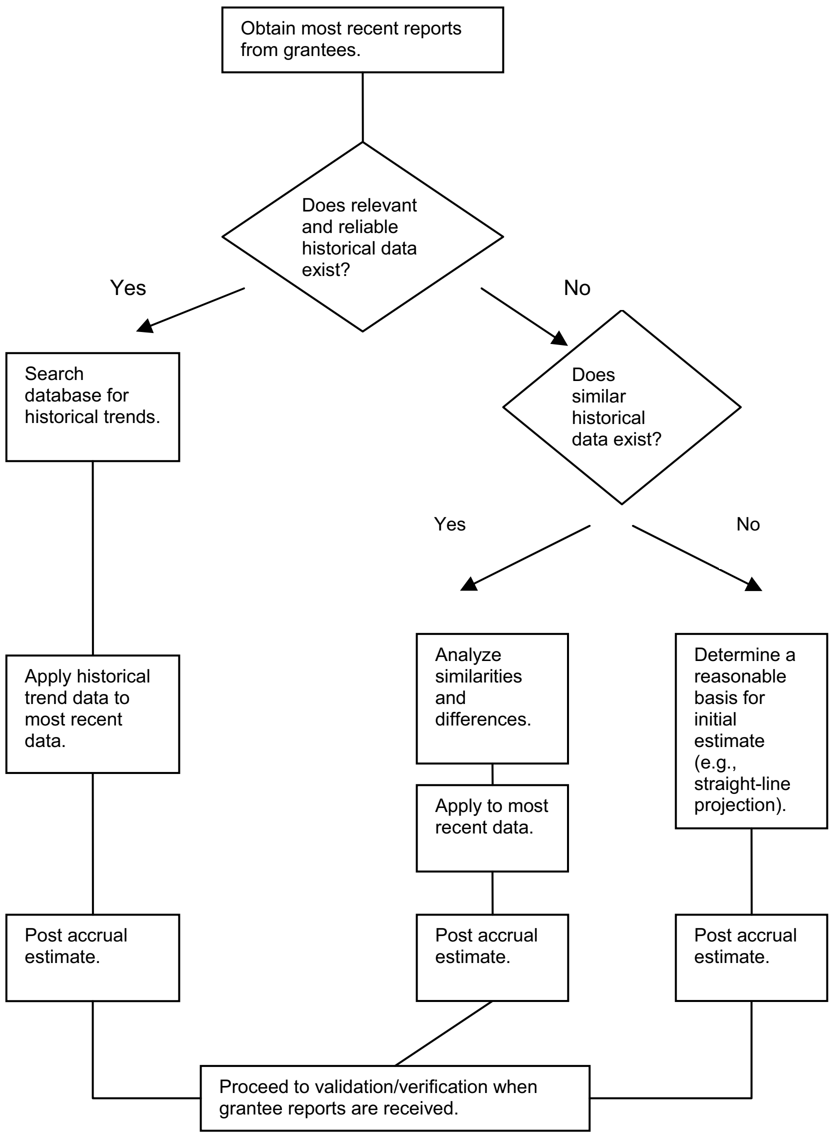
Effective Date

A10. The ED included a provision that the guidance was effective immediately. Two respondents indicated that the effective date should be postponed to a future fiscal year, with earlier implementation encouraged. Although TRs do not establish new reporting requirements, the AAPC has no objection to postponing the effective date to FY 2011 with earlier implementation encouraged.

Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals

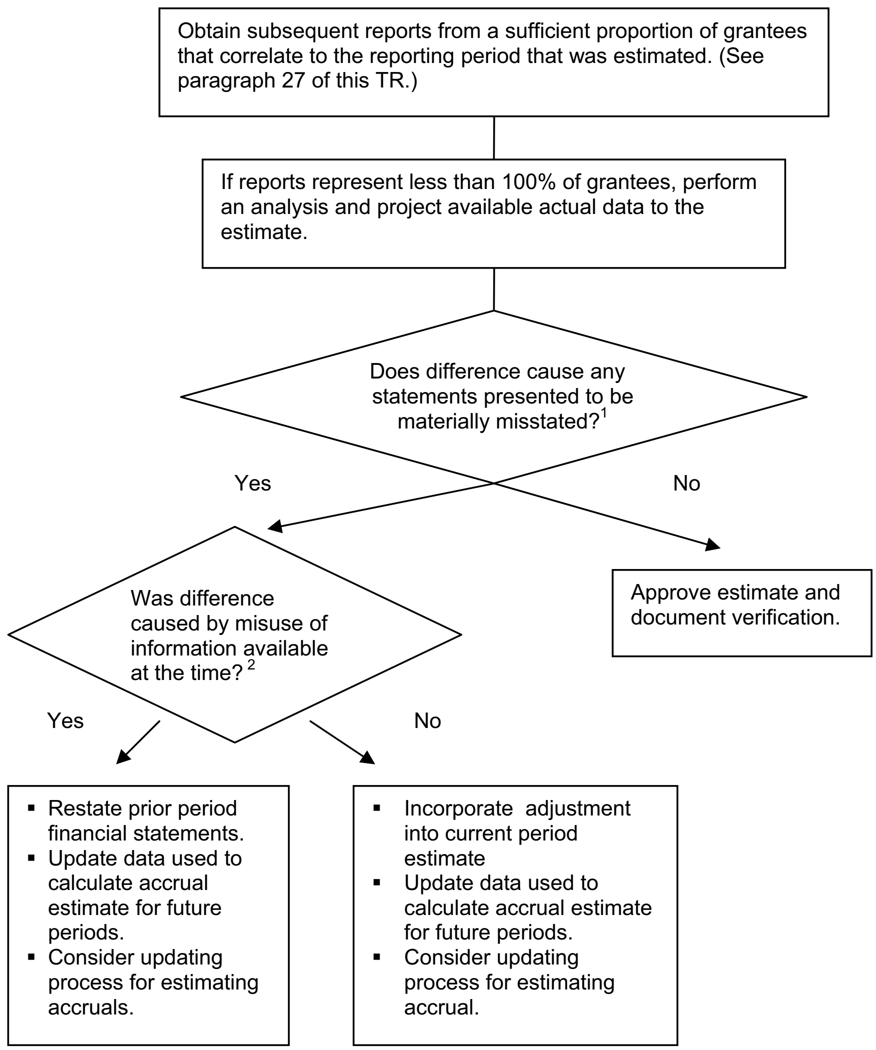
The example decision tree diagram in Figure 1 below illustrates processes that agencies might use in the grant accrual process described in paragraphs 11– 19. This example is illustrative only and is not authoritative guidance.

Figure 1: Illustrative Example of Grant Accrual Process



This example decision tree diagram in Figure 2 below illustrates processes that agencies might use in validating grant accrual estimates in paragraphs 26 - 29. This example is illustrative only and is not authoritative guidance.

Figure 2: Illustrative Example of Validation/Verification Process



[1.] See SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*, paragraph 11.
[2.] See SFFAS 21, paragraph 10.

Appendix C: Relevant Citations of Existing Guidance

Five elements of accrual-based federal financial statements – assets, liabilities, net position, revenues and expenses) are defined in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.*

> An asset is a resource that embodies economic benefits or services that the federal government controls.[13]
>
> A liability is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[14]

Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, defines advances as cash outlays made by a federal entity to its employees, contractors, grantees, or other to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee.[15]

SFFAS 5, *Accounting for Liabilities of the Federal Government*, states that:

> [24.] A nonexchange transaction arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services[16] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).

[13] SFFAC 5, par. 18.

[14] SFFAC 5, par. 39.

[15] SFFAS 1, par. 57.

[16] SFFAS 5, Footnote [12] Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

> [25] Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

SFFAS 5 requires that for grant programs, the liability that should be reported includes the amount of allowable expense that the grantees have incurred as of the end of the period, but have not collected from the agency. Complying with SFFAS 5 requires that the agency estimate the amounts not reported by the grantee but due to the grantee as of the reporting date. When the grantee has submitted subsequent reports providing the grantee's actual costs, the federal agency will be able to assess the grantee reports for accuracy and/or analyze the agency's previous estimate for accuracy.

SFFAS 3, *Accounting for Inventory and Related Property*, "Materiality" section, states that:

> [7.] The Board intends that the standards' application be limited to items that are material. "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. The Board proposes relying on the Financial Accounting Standards Board's (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board's position on the issue of materiality at this time.
>
> [8.] The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.
>
> [9.] FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this 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. 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.
>
> [10.] The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.

[11.] In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.

[12.] This is expressed well in the Government Auditing Standards (the "Yellow Book"):

"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." (Ch. 3, par. 33.)

[13.] While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.

[14.] Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgments of the entity's efficiency and the effectiveness and its compliance with laws and regulations in a material manner.

[15.] In order to emphasize that materiality should be considered in applying all accounting standards, the Board has decided to place a notice at the end of each recommended accounting standard. The notice will read as follows:

Appendix D: AAPC Grants Accounting Task Force

Wendy M. Payne, Task Force Chair (AAPC Chair)

Task Force Working Group:

Department of Health and Human Services	Patricia Irving
DJ Business Solutions	Denise Joseph
Department of Transportation	Katherine Lambert
Grant Thornton LLP	Shal Malhotra
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Department of Commerce
Corporation for National and Community Service
Corporation for National and Community Service OIG
Defense Finance and Accounting Service
Department of Education
Environmental Protection Agency
Executive Office of the President, Office of Administration
General Services Administration
Government Accountability Office
Department of Health and Human Services
Department of Health and Human Services OIG
Department of Housing and Urban Development OIG
Department of Justice
Department of Justice OIG
Department of Labor OIG
National Aeronautics and Space Administration
National Science Foundation
Office of Management and Budget
Small Business Administration

Department of Transportation
Department of Transportation OIG
Department of the Treasury

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Clifton Gunderson LLP
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DJ Business Solutions
Grant Thornton LLP
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Kforce Government Solutions
KPMG LLP
PricewaterhouseCoopers

Technical Release 13: Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment

Status

Issued	June 1, 2011
Effective Date	Upon issuance
Affects	None.
Affected by	Technical Release 17.

Summary

This technical release addresses the historical cost estimating of G-PP&E. The guide provides direction on types of estimating methodologies and the documentation to support the valuation estimates of G-PP&E. This guidance provides a foundation for preparers to exercise judgment in formulating those estimates. The examples outlined illustrate the use of various estimating methodologies to derive the historical cost of G-PP&E in accordance with existing guidance permitting use of estimates.

Table of Contents

Technical Guidance

Paragraphs 1 through 10 were rescinded by Technical Release 17.[1]

Scope

10A. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.* This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

10B. SFFAS 6, *Accounting for Property, Plant, and Equipment,* (as amended) provides that reasonable estimates may be used to establish historical cost of general property, plant, and equipment (PP&E) in accordance with the asset recognition and measurement provisions within SFFAS 6. This is also applicable to internal use software when the software meets the criteria for general PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software*.

10C. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, amended SFFAS 6 to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for general PP&E.

Effective Date

10D. This TR is effective upon issuance.

Examples of Practice

11. The examples outlined in this guide illustrate the use of various estimating methodologies to derive the historical cost of general PP&E in accordance with SFFAS 6, as amended.

[1] Footnote 1 was rescinded by Technical Release 17.

Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended.[1A]

12. Reasonable estimates may be based on

   a. cost of similar assets at the time of acquisition;
   b. current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or
   c. other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.[2,3,4]

12A. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.

13. Agency management is responsible for establishing accounting policies, including the methodologies and bases for estimating historical cost. Management is also responsible for maintaining adequate documentation of the sources of data and the application of methodologies used when estimating historical cost. Management should expect to support estimates with verifiable documented information. Adequate documentation of the source of the data and the application of the methodology used will help support management's assertion that the results are in compliance with accounting standards in all material respects.

14. The specific examples in this guidance are how agencies derived estimated historical costs using the following methods:

   a. Deflation of current replacement costs,

[1A] SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, provides for deemed cost to be used for opening balances in some cases. Estimating historical cost is one of several deemed cost valuation methods. This TR addresses the estimation of historical cost and does not address other acceptable deemed cost methods.

[2] Footnote 2 was rescinded by Technical Release 17.

[3] Footnote 3 was rescinded by Technical Release 17.

[4] Footnote 4 was rescinded by Technical Release 17.

b. Appraisals (with deflation to the year of purchase),

c. Expenditures,

d. Budgets and appropriations, and

e. G-PP&E in possession of Contractors.

Estimates may be based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

15. The following examples provide methods used to estimate G-PP&E historical costs. However, the examples are for illustrative purposes only. The examples are not all-encompassing and agencies may identify other more useful and relevant estimating methodologies. The examples are not meant to be step-by-step instructions on how to develop estimating methodologies. Users of this guidance should use the information provided in these examples to develop their own reasonable estimating methodologies. Federal entities implementing this guidance are also encouraged to discuss any new estimation methodologies with their auditors prior to implementation.

EXAMPLE 1 – Deflation of Current Replacement[5]

16. The following example describes an estimation methodology used by Agency A to establish an estimate of the original cost of a building constructed in 1984. Agency A uses the estimated construction cost of the building in present day dollars and then discounts that value back to the year in which the asset was constructed. Agency A takes the current replacement costs of similar items and deflates those costs, through the Consumer Price Index (CPI). Note that other indices from the Department of Labor's Bureau of Labor Statistics also may be appropriate but were not selected for use in this example.

Population of Data

17. The agency determined the cost of replacing the building in its same physical form (with substantially the same materials and design); then the agency used a pricing index to discount the current asset cost to its estimated cost at the time of acquisition or construction.

[5] Some of the information used in this example was obtained from the Public Sector Accounting Standards Board (PSAB) of the Canadian Institute of Chartered Accountants /Asset Management Newsletter No. 16 (prepared by KPMG).

Assumptions Used

18. The following assumptions were used to estimate the cost of the building and land.

    a. Land was purchased in 1983 and is appraised at $1.5 million in 2008.

    b. A 50,000 square feet building was constructed in 1984, is well maintained and has not received any major betterments except for a 5,000 square foot addition in June 1999.

    c. 2008 replacement cost of the building was estimated at $8.5 million (including $500,000 replacement cost for the addition).

    d. Expected useful life of the building is 40 years and depreciation would be calculated at year 24 of a 40 year asset.

    e. CPI is used for deflating cost. [6]

Calculation of Estimate

19. To estimate the original cost of the building in 1984, Agency A multiplied the current replacement cost of the building ($8.0 million - excluding an addition constructed in 1999) by the CPI (0.4505). Based on this calculation, the deflated cost of the building was approximately $3.604 million in 1984 dollars. Similar calculations using CPI for the addition and land yielded the estimated historical cost of these components of the property. The calculations are presented below.

Table 1:

	2008 Reproduction Cost	Cost Index 19XX/2008	Estimate of Original Cost
Building	$8,000,000	.4505	$3,604,000
Addition	$500,000	.6960	$348,000
Total Building	$8,500,000		$3,952,000
Land	$1,500,000	.4100	$615,000
Total	$10,000,000		$4,567,000

[6] For simplicity the example uses the Consumer Price Index to discount current replacement costs to the year of original purchase or construction. In some cases, the Consumer Price Index may be the only option. However, for some assets a more precise pricing index might be available. For example, the Department of Labor's Bureau of Labor Statistics has an extensive table of indices.

Analysis of Data

20. Once the estimated historical cost of the building was established, the cost was amortized to the 2008 opening balance sheet date using appropriate depreciation rates in order to establish the opening net book value.

Table 2:

At October 1, 2008	Age/Useful Life Years	Estimated Historical Cost	Accumulated Depreciation	Net Book Value
Building	24/40	$3,604,000	$2,162,400	$1,441,600
Addition	9/15	348,000	208,800	139,200
Total Building		3,952,000	2,371,200	1,580,800
Land		615,000	0	615,000
Total		$4,567,000	$2,371,200	$2,195,800

EXAMPLE 2 – Use of Appraisal Information

21. The following example describes an estimation methodology used by Agency B to establish the estimated cost of two vessel classes by the use of third-party appraisals to support asset record adjustments. The example uses estimates obtained from appraisals to validate the value of the vessels and to determine necessary adjustments to Agency B's core accounting system.

Population of Data

22. In order to populate the data for estimation, Agency B performed several of the following procedures.

    a. Agency B conducted a physical inventory to ensure that assets identified for appraisal could still be physically located and were still in service. Physical inventories were conducted using:

        i. on-site vouching,

        ii. digital photos with newspaper showing the date and location, or

iii. authorized maintenance or operations applications to confirm existence.

b. Agency B reviewed and, if needed, updated date-in-service (DIS) from historical information.

c. Agency B determined that records in the accounting system were consistent with the inventory and DIS.

d. Agency B ensured that assets within a class were similar in configuration.

e. The Agency B program offices were used to gather “technical engineering” information (e.g. type of engines, technical updates).

Assumptions Used

23. The following assumptions were used to estimate the cost of the sea vessels.

a. Agency B did not provide cost, accumulated depreciation and net book value to appraisers to avoid the possibility that these values might influence the third-party appraisers output. Values are appraised using a deflation factor to year of purchase.

b. If there was no DIS for a vessel, an average DIS was determined by using the DIS from the first and last vessels placed in service. The asset’s acquisition cost was then “indexed” by using an appropriate Bureau of Labor Statistics pricing index.

c. Appraisal specialist determined appraisal value using a desktop appraisal approach.[7]

Analysis of Data

24. An appraisal report containing an individual valuation (estimated acquisition cost) for each asset as of the identified date of the report or appraised value as of original date in service (contract specific) was provided to Agency B. The agency performed many of the following analytical processes.

a. An Agency B subject matter expert reviewed and approved appraisal report.

[7] A “desktop” appraisal is when an appraiser estimates the value of a property without a physical inspection, but uses property records. The desktop approach was used by Agency B for appraisals and cost estimates due to the cost benefits; it is less costly to an agency than a physical inspection appraisal.

b. If there was no DIS for a vessel, an average DIS was determined by using the DIS from the first and last vessels placed in service. The asset's acquisition cost was then "indexed" by using an appropriate Bureau of Labor Statistics pricing index.

c. The appraisal/calculated cost was compared to official fixed assets record cost to determine asset cost difference.

d. Agency B prepared a detailed summary of differences by asset (and class) to compare cost and accumulated depreciation.

e. The data was reviewed and approved by appropriate Agency B personnel.

f. Documentation was prepared containing support of the fixed asset adjustments needed.

Calculation of Estimate

25. Agency B then analyzed the financial statement impact of the appraisal process to determine needed adjustments.

Table 3:

ASSET CLASS (#)	Delivery Start Delivery End	System Acquisition Cost per Fixed Asset Records	Appraisal Value less Fixed Asset Records Acquisition Cost	Appraisal Value less Fixed Asset Records Depreciation Expense	Net Change
Vessel Class I (16 VSLS)	FY96 FY04	$607.9M	$(60.1)M	$3.0M	$(57.1)M
Vessel Class II (65 VSLS)	FY 98 FY06	287.4M	7.6M	(5.7)M	1.9M
Totals		$895.3M	$(52.5)M	$(2.7)M	$(55.2)M

Once the appraised values were accepted, necessary adjustments were made to the system (asset by asset/lump sum) to determine the estimated historical cost of the vessel classes.

EXAMPLE 3 – Use of Expenditure Information

26. Agency C used the following procedures to estimate its real property values by the use of expenditures. Expenditures were available on a project basis but each project produced multiple assets. The objective was to assign reliable project cost to individual assets based on estimates.

Population of Data

27. Agency C real property personnel first examined their records to determine whether a complete and current inventory of real property by individual project was available. If the specific inventory of a complete project did not exist an inventory would be obtained from project personnel on-site.

28. An Agency C real property work group then obtained a summary of actual capitalized project costs by real property class (i.e., Land, Dams, Levees, Buildings, Grounds, etc.).

Analysis of Data & Calculation of Estimate

29. Once the work group had both a project specific inventory of all real property assets and a breakout of the actual capitalized costs by project and class, they began the process of assigning a value to each asset within a project not to exceed the total project cost. Utilizing all available real estate records, project records, assistance from cost estimating personnel, comparative data at other projects, real estate financial information, operations data, engineer estimates, plus video tapes, photographs, narrative descriptions of the structure and professional judgment the work group either used actual cost or estimated the cost of each asset ensuring the total dollars assigned agreed with the total cost for each project as recorded in Agency C's financial subsystem.

EXAMPLE 4 – Use of Budget and Appropriation Information

30. The following example outlines steps for estimating the historical cost of existing assets using budget and appropriation information.

Assumptions Used

a. Congress appropriated funds to Agency D in FY 2007 to acquire 9 aircraft.

b. As of the estimation date, 7 of the 9 aircraft have been delivered.

Analysis of Data & Calculation of Estimate

31. The steps of this process include:

a. Verification of existence of the asset acquired.

b. Estimation of total historical cost for the asset group

c. Documentation

32. Verification of existence

a. Prior to delivery, all costs associated with the items were reported in an appropriate asset account. When the asset was delivered it was recorded in an accountability system of record (ASR) and the completed asset was subject to inventory/existence verification.

b. The asset management system was updated when data on the receipt of the aircraft was sent from the reporting entity's property accountability system of record. The acknowledgment of delivery serves as proof that the aircraft assets were received. Continued existence of the asset was verified through periodic inventories.

33. Estimation of total historical cost for the asset group

a. The recorded cost of the assets should represent the "historical cost", including costs associated with getting the asset to a form and location suitable for its intended use.

b. The asset valuation is based on the Budget of the U.S. Government (commonly referred to as the President's Budget request). The Budget and related budget justification materials provided detailed supporting information that facilitated congressional review of budget requests. As the entity is reviewing the budget information for inclusion in the estimate, the entity should also review related information, such as planning documents, to identify other material costs associated with getting the asset to a form and location suitable for its intended use. If material, such costs should be estimated. For simplification of this example, the other associated costs are not shown in the below example.

Table 4 below shows the FY 2007- Funded aircraft cost based on amounts included in the Budget.

Table 4 - Calculations to Determine the Cost of FY 2007-Funded Aircraft ($ in Millions)	
Procurement cost for 9 aircraft based on budget estimates	$722.6
Less support equipment*	(81.1)
Total cost for the 9 aircraft	$641.5
Average cost ($641.5M ÷ 9)	$ 71.3[8]

*The supporting equipment is subtracted from the aircraft procurement cost in order to capitalize this equipment separate from the cost of the aircraft.

c. The Agency D Appropriation Act and/or the conference report accompanying it is used to identify the amount of program funding provided by Congress to address requirements identified in the Budget. Amounts appropriated may frequently differ from amounts requested in the Budget. The related congressional committee or conference report on the appropriation may explain the rationale for the change from the amount requested in the Budget.

Table 5 below shows the amount of the congressional appropriation for the aircraft less the value of excluded amounts. Excluded amounts were based on detail included in the Budget.

Table 5 - Appropriation Amount Less Excluded Items for Aircraft ($ in Millions)	
Provided in FY 2007 Appropriations Act	$725.0
Less support equipment (Based on budget detail)*	(81.1)
Adjusted appropriated amount for the 9 aircraft	$643.9
Average cost ($643.9M ÷ 9)	$ 71.5

*The funding for support equipment was not separately identified in the appropriation. For cost purposes, the amount included in the Budget estimate ($81.1M) was used.

d. Adjustments to funds available to a program may frequently occur over the life of the appropriation. These adjustments, which can increase or decrease available funds,

[8]Valuations based on budget information may need to be revised to address material revisions that occur subsequent to budget submission during the appropriation and funds allocation processes.

result from actions including congressional rescissions and Departmental reprogrammings.

Table 6 below shows the aircraft cost as adjusted to account for a subsequent year Congressional rescission.

Table 6 - Appropriation Amount Less Excluded Items for Aircraft* ($ in Millions)	
Adjusted appropriated amount for the 9 aircraft	$643.9
Less Congressional rescission for the aircraft	(9.9)
Total appropriated amount for the 9 aircraft	$634.0
Average cost ($634.0M ÷ 9)	$ 70.4

*The capitalized cost may not exceed the appropriated amount as adjusted by Departmental reprogramming and congressional rescissions, (i.e., the amount shown in Table 6).

34. Documentation

a. Agency D maintains sufficient and appropriate documentation relating to: (1) existence; (2) cost analysis techniques; (3) data source; and (4) reasonableness of the estimation methodology.

EXAMPLE 5 – G-PP&E in the Possession of Contractors

35. The following example summarizes the procedures used at Agency E for estimating the cost of G-PP&E in the possession of its contractors. This estimate may be used when the agency lacks internal documentation and/or when the cost of reconstructing records using internal documentation is cost prohibitive.

36. Contractors generally follow a process similar to the one described below, when estimating the value of G-PP&E manufactured or acquired for federal agencies, referred to in this example as contractor-held G-PP&E. These acquisitions may be held for use by the contractor, held for use by other contractors, or transferred to a federal entity for its direct use. The values are typically estimated by the contractor first obtaining a Bill of Material (BOM) for every part required to complete the G-PP&E asset being constructed. The BOM can have cost, quantity, part description, raw materials used, etc. Also, Contractors typically add estimated labor cost. This labor value is then added to the BOM cost to derive a total estimated direct cost for the G-PP&E asset. Further, Contractors apply overhead and, when applicable, other indirect markups. The sum total for the asset is the basis used to support GPP&E recorded by Agency E.

37. Agency E has procedures in place to provide reasonable assurance that the contractor-provided estimates of the value of manufactured items are reasonable. The processes described below are intended to provide Agency E with relevant, sufficient and reliable information on which to base its estimate of contractor-held G-PP&E.

Population of Data

38. Agency E contractors are required to report information related to acquisitions, fabrications and/or disposals of individual G-PP&E items to Agency E on a regular basis. To facilitate reporting, Agency E utilizes an automated reporting tool, when appropriate, to receive this information from its contractors and maintains control over this information prior to it being entered into the property accounting system.

Analysis of Data

39. Agency E employs a series of controls over the preparation of contractor accounting estimates and supporting data, including assessments and validation procedures that are applied through independent external parties and/or internal agency resources.

External Third Party Procedures

40. When practical and cost effective, Agency E leverages to the extent possible independent assessments performed by external parties. The objective of these assessments is to provide Agency E with reasonable assurance that contractor property, logistics and cost accounting systems comply with federal requirements designed to provide a reasonable estimate of the G-PP&E data.

41. An Agreed upon Procedures (AUP) review of Agency E’s major contracts is one example of an independent assessment. The contracts subject to the AUP reviews are selected using a risk-based approach. The AUPs include a review of the contractor’s policies, procedures and internal controls relevant to the contractor's cost accounting, logistics and production systems. The intention of the assessments is to validate the accuracy, reliability, existence, and completeness of contractor reported G-PP&E data through an analysis of transaction samples.

Internal Third Party Procedures

42. Agency E's procurement, logistics, project management, and finance personnel also performed oversight and validation activities over contractor estimate submissions on an on-going basis.

43. Agency E procurement personnel, for example, oversee the execution of contractor work as required by the contracts in accordance with the FAR. This step is to provide reasonable assurance that the work for which costs are being estimated is being performed as contracted. Agency E contracting officers have a key role in the systems of controls and validation procedures by ensuring that specific clauses are included in the contracts and that contract terms and conditions are adhered to by the contractor.

44. Agency E logistics personnel, acting as Government Property Administrators, conduct reviews to assess the effectiveness of the contractor's government property management systems.

45. Program and Project managers review the information provided by contractors against established plans and approve or disapprove contractor reported incurred costs, as appropriate. This critical information supports the reasonableness of contractor provided information.

Calculation of Estimate

46. Agency finance personnel perform reviews of the information reported by contractors prior to recording G-PP&E estimates. Periodic validation procedures may include performing analytical procedures over the account balances to explain period-to-period fluctuations, reconciling the data reported by the contractor to the agency's financial system, tracing activity to supporting documentation, and validating ownership of property.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

A1. In January 2008, the Accounting and Audit Policy Committee established the General Property, Plant, & Equipment (G-PP&E) task force to assist in developing implementation guidance for federal G-PP&E as it relates to SFFAS 6, *Accounting for PP&E,* SFFAS 23, *Eliminating the Category National Defense Property Plant, & Equipment*, and other related G-PP&E Guidance developed by the FASAB. The task force included federal agency representatives who were experiencing G-PP&E implementation issues and those who have G-PP&E implementation best practices to share with the federal community.

A2. The G-PP&E task force was divided into four subgroups that addressed a set of related issues. The subgroups met separately on a regular basis to discuss their set of issues and reported back to the full task force on its progress towards the development of implementation guidance. The four sub-groups were:

- G-PP&E Acquisition
- G-PP&E Use
- G-PP&E Disposal
- G-PP&E Records Retention

A3. This guidance was developed by the Acquisition subgroup. The subgroup included members from the following federal agencies:

- Department of Defense
- Department of Energy
- Department of the Interior
- Government Accountability Office
- General Services Administration
- National Aeronautics and Space Administration

A4. The purpose of this implementation guidance is to provide support and direction relative to the types of estimating methodologies and the documentation that could be used to support the valuation estimates as outlined in SFFAS 6, 23, and 35. It does not address the need to validate existence and completeness. This guidance provides a foundation for preparers to exercise judgment in formulating those estimates.

A5. This implementation guide provides examples that federal entities can use as guidelines when developing G-PP&E estimates of original transactional data historical costs in accordance with the standards.

A6. The AAPC released the exposure draft (ED), *Implementation Guidance for Estimating the Historical Cost of General Property, Plant, and Equipment* on December 10, 2010. 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 committees of professional associations commenting on past exposure drafts.

A7. Fifteen letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	3	
Preparers and financial managers	10	

A8. Respondents were primarily supportive of the examples provided. Some respondents provided editorial suggestions and many were adopted.

Records Retention Requirements Presented in the Exposure Draft

A9. The Committee asked readers of the exposure draft to comment on the proposed recommendations of the AAPC G-PP&E task force -- Records Retention sub-group. No changes were suggested by respondents and these recommendations have now been forwarded to the National Archives and Records Administration (NARA) for consideration. Through its General Records Schedule (GRS) NARA specifies the minimum period for retaining paper and electronic financial records documenting the acquisition of PP&E. The Federal Acquisition Regulation (FAR) also provides guidance for retaining historical cost data. The subgroup was tasked with developing recommendations for the consistent records retention policies specifically for G-PP&E.

A10. The objective of the Records Retention subgroup was to look into the issue of records retention timeframes and methods (hardcopy vs. electronic) for records that support G-PP&E reported in agencies' general purpose financial statements and make cost-beneficial recommendations. The subgroup found that policies varying regarding retention timeframes and the types of records to support assertions related to G-PP&E. The subgroup's research and recommendations were limited to records retention guidance and practices for the G-PP&E category.

Appendix B: Abbreviations

AAPC	Accounting and Auditing Policy Committee
AICPA	American Institute of Certified Public Accountants
AUP	Agreed Upon Procedures
CEFMS	Corps of Engineers Financial Management System
CIP	Construction in Process
COEMIS	Corps of Engineers Management Information System
DIS	Date-In-Service
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
G-PP&E	General Property, Plant, and Equipment
GRS	General Records Schedule
IPA	Independent Public Accountant
NARA	National Archives and Records Administration
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PB	President's Budget
PP&E	Property, Plant, and Equipment
SAS	Statement on Auditing Standards
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release
USACE	United States Army Corps of Engineers
USCG	United States Coast Guard

Technical Release 14: Implementation Guidance on the Accounting for the Disposal of General Property, Plant, and Equipment

Status

Issued	October 6, 2011
Effective Date	Upon issuance
Affects	None.
Affected by	None.

Summary

This technical release addresses implementation guidance that further clarifies existing SFFAS 6 requirements for the disposal, retirement, or removal from service of general property, plant, and equipment as well as related cleanup costs. The implementation guidance should help differentiate between permanent and other than permanent removal from service of G-PP&E assets. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

Table of Contents

Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment,* (paragraphs 38 and 39) outlines the requirements for the disposal, retirement, or removal from service of general property, plant, and equipment (G-PP&E). SFFAS 6 (paragraphs 97 and 98) outlines the requirements for recognition and measurement of disposal related cleanup costs. The Accounting and Auditing Policy Committee (AAPC) G-PP&E Disposal subgroup requested implementation guidance to clarify these requirements. Many question whether the existing guidance applies solely to permanent removal from service of G-PP&E assets. For example, SFFAS 6 does not provide guidance regarding G-PP&E returned to service because removal was not permanent, such as whether the valuation should be restored to acquisition cost or remain at net realizable value. Uncertainty regarding the application of SFFAS 6 provisions to G-PP&E not permanently removed from service as well as uncertainty in determining when removal is permanent contributes to inconsistencies in interpretation and implementation of the standards.

2. Implementation guidance is needed to recognize the many complexities involved in disposal of G-PP&E and should identify events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records. The purpose of this technical release is to provide implementation guidance that further clarifies the requirements stated in the above noted SFFAS 6 paragraphs.

Scope

3. Readers of this technical release should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. 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 clarifies, but does not change, guidance previously provided in SFFAS 6.

Effective Date

4. This technical release is effective upon issuance.

Technical Guidance

SFFAS 6: Disposal of G-PP&E

5. In accordance with SFFAS 6 paragraph 38, “in the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization.”

   Further, paragraph 39 (**bold added**)[1] states that:

   General PP&E shall be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This either could be because it has suffered damage, becomes **obsolete** in advance of expectations, or is identified as **excess**. It shall be recorded in an appropriate asset account at its expected **net realizable value**. Any difference in the book value of the PP&E and its expected net realizable value shall be recognized as a gain or a loss in the period of adjustment. The expected net realizable value shall be adjusted at the end of each accounting period and any further adjustments in value recognized as a gain or a loss. However, no additional depreciation/amortization shall be taken once such assets are removed from general PP&E in anticipation of disposal, retirement, or removal from service.

SFFAS 6: Recognition of Cleanup Costs Associated with Disposal of G-PP&E

6. Additionally, SFFAS 6 provides requirements for recognition and measurement of disposal related cleanup costs. In accordance with paragraphs 97 and 98:

   A portion of estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E (e.g., expected usable landfill area) whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as

[1] Terms defined in the Glossary are shown in bold-face type the first time they appear.

the basis for systematic and rational recognition of expense and accumulation of the liability.

Recognition of the expense and accumulation of the liability shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation.

Other than Permanent vs. Permanent Removal from Service

7. The following section provides further clarification and guidance to the requirements stated in SFFAS 6, paragraphs 38, 39, 97, and 98 as those paragraphs relate to "removal from service." The terms "disposal" and "retirement" are used in the above referenced SFFAS 6 paragraphs and are intended to describe G-PP&E disposals that are permanent in nature. However, "removal from service" may or may not be permanent. The paragraph below defines the term "removal from service", as referenced in SFFAS 6, and further discusses the differences between other than permanent and permanent removal from service.

8. "Removal from service"[2] is defined as an event that terminates the use of a G-PP&E asset (e.g., shut down of a facility). Removal from service may occur because of a change in the manner or duration of use, change in technology or obsolescence, damage by natural disaster, or identified as excess to entity's mission needs. The removal from service should be considered other than permanent, unless there is evidence of management's documented decision to permanently remove the asset from service and the asset's use is terminated.[3] Permanent removal from service is evident from management's documented decision to dispose of an asset by selling, scrapping, recycling, donating or demolishing the asset. An entity's policies and procedures should require that documentation exists of management's decision to permanently remove an asset from service.

9. Management's decision to remove from service is evidenced by the actions taken to commence the retirement and/or disposal process in accordance with the entity's policies and procedures. Other than permanent removal from service is evidenced by activities such as continuing low-level maintenance to sustain the asset in a recoverable status or until reutilization efforts are exhausted. For example, processing an aircraft or idling a

[2] The term "removal from service" does not include the "out grant" of an asset. "Out grant" is defined as interest or right granted to another entity to use government property by a lease, easement, license, or permit. Therefore, "removal from service" as defined in this document does not apply to out granted assets, because the government retains its ownership in the property and only the use of the property is given to the entity using the out granted asset.

[3] The agency's management may elect to identify and/or classify the operational status of assets to include those other than permanently removed from service in the property accountability system.

facility in such a way as to retain the potential for its future operability would be persuasive evidence of intent to preserve an option to return the asset to service if warranted by evolving mission requirements.

10. Two business events are necessary for the permanent removal from service:

    1. Asset's use is terminated, and

    2. There is documented evidence of management's decision to permanently remove the asset from service.

    If only one of the two business events has occurred, permanent removal from service has not occurred (i.e., considered other than permanent removal) and there is no change in the G-PP&E reported value and depreciation continues.

    Likewise, in the case of G-PP&E cleanup costs, if only one of the two business events has occurred, permanent removal from service has not occurred (i.e., considered other than permanent removal) and, any cleanup costs associated with disposal, closure, and/or shutdown should continue to accumulate as a liability in accordance with SFFAS 6, paragraphs 97 and 98.

Financial Accounting Transactions

11. The following section describes the financial accounting transactions that result from permanent removal, retirement, and/or disposal of G-PP&E. No disposal related entries are recognized prior to permanent removal from service.

12. G-PP&E Acquisition Cost & Depreciation at Permanent Removal - When the entity's management decides to permanently remove, retire, and/or dispose of an asset from service and the asset's use is terminated, the asset's acquisition cost and associated accumulated depreciation are removed from the G-PP&E account and the asset is recorded at its net realizable value with an offsetting entry to gain or loss.[4] Upon completion of the disposal of the asset, the entity should write off the asset from its financial records. Any difference between the expected net realizable value of the G-PP&E previously recorded and the actual disposition amount should be recognized as a gain or loss.

[4] Refer to Appendix B: Table 1: Scenarios I & II, Step 2 for account transactions.

13. Spare Parts and Subcomponents - If during the permanent removal process, the asset is dissembled and spare parts or sub-components are salvaged to be used for other purposes, the spare parts or sub-components should be recorded as new and separate assets in accordance with SFFAS 6 or SFFAS 3, *Accounting for Inventory and Related Property*.

14. G-PP&E Acquisition Cost & Depreciation at Other than Permanent Removal - If the asset's normal use is terminated but management has not decided to permanently remove the asset from service, the asset's removal is considered other than permanent. In this case, there is no change in the G-PP&E reported value and depreciation continues.[5] Likewise, if the asset is still in use even though management has decided to permanently remove, retire and/or dispose of the asset, the permanent removal from service has not occurred. There is also no change in the G-PP&E reported value and depreciation continues.[6]

15. G-PP&E Cleanup Costs[7] - For assets permanently removed from service, the cleanup cost liability associated with the disposal, closure, and/or shutdown of the G-PP&E should be recognized in full. If removal from service is considered other than permanent, the liability and associated clean up cost expense shall continue to accumulate.[8]

16. G-PP&E Disposal When Group or Composite Depreciation is Used - G-PP&E subject to a group or composite method of depreciation should only apply the accounting transactions outlined in paragraph 12 when the entire group has been permanently removed from service (e.g., as if the entire group were one asset). Under the group or composite depreciation methods, no gain or loss is recognized on the sale of an asset within the group prior to removal of all assets in the group. The pro rata share of the total original group cost may be used to determine the cost of an asset within the group.

17. Table 1 in Appendix B illustrates two different scenarios, associated business events, and derived financial transactions to assist in interpretation and application of the guidance described in paragraphs - 11-15.

The provisions of this Technical Release need not be applied to immaterial items.

[5] Refer to Appendix B: Table 1, Scenario I, Step 1.

[6]Refer to Appendix B: Table 1, Scenario II, Step 1.

[7] SFFAS 6, paragraph 85: Cleanup costs are 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.

[8]Regardless of when cleanup is executed, at temporary or permanent shut down, as cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. (SFFAS 6, paragraph 100)

Appendix A: Basis for Conclusions

A1. In January 2008, the Accounting and Audit Policy Committee established the General Property, Plant, & Equipment (G-PP&E) task force to assist in developing implementation guidance for federal G-PP&E as it relates to SFFAS 6, *Accounting for Property, Plant, and Equipment, SFFAS 23, Eliminating the Category National Defense Property Plant, & Equipment,* and other related G-PP&E Guidance developed by the FASAB. The task force included federal agency representatives who were experiencing G-PP&E implementation issues and those who have G-PP&E implementation best practices to share with the federal community.

A2. The G-PP&E task force was divided into four subgroups that addressed a set of related issues. The subgroups met separately on a regular basis to discuss their set of issues and reported back to the full task force on its progress towards the development of implementation guidance. The four original subgroups were:

- G-PP&E Acquisition
- G-PP&E Use
- G-PP&E Disposal
- G-PP&E Records Retention

A fifth subgroup (G-PP&E Cost Accounting Issues) was added recently to address the complexities of allocating programmatic, managerial, and administrative costs to G-PP&E.

A3. This guidance was developed by the Disposal subgroup. The subgroup included members from the following federal agencies:

- Department of Defense
- Department of Energy
- Department of the Interior
- Government Accountability Office
- General Services Administration
- National Aeronautics and Space Administration

The subgroup included accountants, program managers, and functional PP&E experts. The program managers gave the subgroup the perspective of how the standards come into play on a day-to-day basis.

A4. The scope of the implementation guidance is to address G-PP&E disposal as it applies to SFFAS 6. The guide focuses on when G-PP&E is disposed, retired, or removed from service.

A5. This implementation guide provides steps that can be followed to help federal entities consistently apply existing standards in providing consistent and comparable information.

A6. In reaching its conclusions, the subgroup deemed significant the unanimous agreement of its members that SFFAS 6 as currently written applies only to permanent removal from service of G-PP&E assets. Because some G-PP&E is removed from service in other than a permanent manner there are inconsistencies in interpretation and implementation of the guidance. The subgroup members presented numerous compelling examples of misinterpretation, confusion, and inefficient implementation. The subgroup was convinced that guidance is needed to clarify when G-PP&E has been removed from service as envisioned in SFFAS 6.

A7. Additionally, subgroup members universally felt strongly that the implementation guidance should consider the cost vs. benefits of the many complexities involved in G-PP&E disposal, retirement, or removal from service and recognize the potential for reversing disposal decisions as mission requirements change. Therefore, the subgroup members decided to focus on permanent removal from service and ultimately continuing to depreciate and report assets as GPP&E that are other than permanently removed from service. The following reasons were discussed:

a. Depreciation is a method of allocating the cost of the asset to those periods expected to benefit from use of the asset. When assets are other than permanently removed from service, there is a great possibility of returning the assets to service; therefore management continues to maintain the assets in a mission ready status and the assets are available for use. Given this, the entity should continue depreciating its assets.

b. The subgroup members determined that the complexity and cost of continually suspending and reinstating depreciation for assets other than permanently removed from service outweighs the benefits. Further, SFFAS 6 does not provide guidance for the recognition of assets returned to service following other than permanent removal.

c. Current guidance requires depreciation to be captured until the asset is either fully depreciated or permanently removed from service. In the cases where an entity depreciates its G-PP&E based on actual usage or production, the depreciation expense for the entity would stop when the asset is not in use. For example, an agency can decide to use a depreciation method, such as flying hours, that would account for an asset's 'lack of activity.'

d. Changes in value or useful lives of assets remaining in service regardless of the reason (e.g. impairment) are outside of the scope of this document.

A8. The benefits of this guidance are: (1) it facilitates comparable implementation of federal accounting standards; and (2) it supports federal financial reporting objectives including the assessment of the performance of agencies in managing the cost and disposition of federal assets.

A9. As part of the implementation of this guide, the federal agencies may incur additional costs to: (1) review and adjust the expected net realizable value at the end of each accounting period and any further adjustments in value recognized as a gain or a loss; (2) periodically review the status of those assets in the other than permanently removed from service group, but not all PP&E, to determine if any changes in status or actions would trigger a change in G-PP&E recognition; and (3) demonstrate and support management's intent to retain an asset for future use or permanently dispose of the asset and any associated financial transactions, when applicable.

A10. The guidance defines "removal from service" as an event that terminates the use of a G-PP&E asset (e.g., shut down of a facility). Management's decision to remove from service is evidenced by the actions taken in accordance with the entity's policies and procedures to commence the retirement and/or disposal process. Permanent removal from service is evident from management's documented decision to dispose of an asset by selling (including selling the asset to another entity for use as its original intended purpose), scrapping, recycling, donating or demolishing the asset. Removal from service may occur because of a change in the manner or duration of use, change in technology or obsolescence, damage by natural disaster, or identified as excess to entity's mission needs.

A11. The exposure draft, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, was issued December 10, 2010, with comments requested by February 11, 2011. Upon release of the exposure draft, notices and press releases were provided to The Federal Register, *FASAB News*, *The Journal of Accountancy*, *AGA Today*, *the CPA Journal*, *Government Executive*, *the CPA Letter*, and *Government Accounting and Auditing Update*, The CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and, committees of professional associations generally commenting on exposure drafts in the past.

A12. Eighteen letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		3
Auditors	3	2
Preparers and financial managers	10	

A13. Respondents were predominantly supportive of the implementation guidance. Some respondents provided editorial suggestions and many were adopted. One respondent expressed the view that introduction of two key terms – temporary and permanent removal from service – which bifurcate the principles established in SFFAS 6 is inappropriate in a technical release. The AAPC believes SFFAS 6 addresses only permanent removal from service. To avoid introducing the new phrase “temporary removal from service” the guidance proposed in the exposure draft was revised to “other than permanently removed from service.”

A14. The Technical Release was approved by the AAPC for release to the FASAB for issuance. The Board has reviewed this Technical Release and a majority of its members do not object to its issuance.

Appendix B: Illustrations

Table 1: Disposal, Retirement, Removal Business Events & Financial Accounting Transactions

Table 1 below illustrates two different scenarios, associated business events, and derived financial accounting transactions to assist in interpretation and application of the guidance described in paragraphs 11-15. Further, it demonstrates that both business events (steps 1 and 2) must be in place to trigger a disposal financial transaction in accordance with SFFAS 6. These illustrative financial transactions are considered non-authoritative guidance and are presented to show how the standards may be applied but are not standards themselves. These illustrations are general in nature and may not apply to specific cases that appear similar but have unique circumstances.

Scenarios for SFFAS 6	Business Event	Financial Event	Proprietary Disposal Financial Accounting Transaction For Illustrative Purposes Only[9]
SCENERIO I: Step 1. Asset's use is FIRST terminated.	Step 1: Asset's use is terminated and removed from service (e.g., asset is vacated, abandoned, or deactivated). At this point the removal from service (*termination of use*) is deemed other than permanent until management documents that it has decided to permanently retire/dispose of the asset (shown in step 2).	Step 1: No change in the financial status. Continue to carry book value in G-PP&E account and depreciate	None

Scenarios for SFFAS 6	Business Event	Financial Event	Proprietary Disposal Financial Accounting Transaction For Illustrative Purposes Only[9]
Step 2. LATER management decides to permanently retire and/or dispose of the asset.	Step 2: Management decides to permanently retire and/or dispose of the asset and documents its decision.	Step 2: Reclassify and remove G-PP&E and associated accumulated depreciation from the G-PP&E account. Record asset at the net realizable value. Any difference between the book value of the G-PP&E and the expected net realizable value should be recognized as a gain or a loss. Recognize any unallocated/unamortized portion of the total estimated cleanup costs.	Debit GPP&E Permanently Removed but not yet Disposed Debit Accumulated Depreciation on Improvements to Land Debit Accumulated Depreciation on Buildings, Improvements, and Renovations Debit Accumulated Depreciation on Other Structures and Facilities Debit Accumulated Depreciation on Equipment Debit Accumulated Depreciation on Assets Under Capital Lease Debit Accumulated Amortization on Leasehold Improvements Debit Losses Credit Gains Credit Land and Land Rights Credit Improvements to Land Credit Buildings, Improvements, and Renovations Credit Other Structures and Facilities Credit Equipment Credit Assets Under Capital Lease

Scenarios for SFFAS 6	Business Event	Financial Event	Proprietary Disposal Financial Accounting Transaction For Illustrative Purposes Only[9]
			Credit Leasehold Improvements Debit Future Funded Expenses Credit Estimated Cleanup Cost Liability
	Step 3: Disposition is completed. The title and/or any legal interest in the asset has been transferred and/or ceased. (e.g., transfer/sale document or title has been signed and executed by the appropriate authority)	Step 3: Write off the asset from financial records and statements. Any difference between the expected net realizable value of the G-PP&E previously recorded and the actual disposition amount should be recognized as a gain or loss.	Debit Fund Balance With Treasury Debit Accounts Receivable Debit Losses on Disposition of Assets Credit GPP&E Permanently Removed but not yet Disposed Credit Gains on Disposition of Assets
SCENERIO II: Step 1. FIRST management decides to permanently retire and/or dispose of the asset while the entity continues to use/operate the asset.	Step 1: Management decides to permanently retire and/or dispose of the asset and documents its decision. At this point, the entity continues to use the asset.	Step 1: No change in the financial status. Continue to carry book value in G-PP&E account and depreciate	None

Scenarios for SFFAS 6	Business Event	Financial Event	Proprietary Disposal Financial Accounting Transaction For Illustrative Purposes Only[9]
Step 2. LATER the decision is made to terminate the asset's use/operation.	Step 2: Asset's use is terminated and removed from service (e.g., asset is vacated, abandoned, or deactivated).	Step 2: Reclassify and remove G-PP&E and associated accumulated depreciation from the G-PP&E account. Record asset at the net realizable value. Any difference between the book value of the G-PP&E and the expected net realizable value should be recognized as a gain or a loss Recognize any unallocated/unamortized portion of the total estimated cleanup costs.	Debit GPP&E Permanently Removed but not yet Disposed Debit Accumulated Depreciation on Improvements to Land Debit Accumulated Depreciation on Buildings, Improvements, and Renovations Debit Accumulated Depreciation on Other Structures and Facilities Debit Accumulated Depreciation on Equipment Debit Accumulated Depreciation on Assets Under Capital Lease Debit Accumulated Amortization on Leasehold Improvements Debit Losses Credit Gains Credit Land and Land Rights Credit Improvements to Land Credit Buildings, Improvements, and Renovations Credit Other Structures and Facilities Credit Equipment Credit Assets Under Capital Lease

Scenarios for SFFAS 6	Business Event	Financial Event	Proprietary Disposal Financial Accounting Transaction For Illustrative Purposes Only[9]
			Credit Leasehold Improvements Debit Future Funded Expenses Credit Estimated Cleanup Cost Liability
	Step 3: Disposition is completed. The title and/or any legal interest in the asset has been transferred and/or ceased. (e.g., transfer/sale document or title has been signed and executed by the appropriate authority)	Step 3: Write off the asset from financial records and statements. Any difference between the expected net realizable value of the G-PP&E previously recorded and the actual disposition amount should be recognized as a gain or loss.	Debit Fund Balance With Treasury Debit Accounts Receivable Debit Losses on Disposition of Assets Credit GPP&E Permanently Removed but not yet Disposed Credit Gains on Disposition of Assets

[9]Any combination of these accounts could be recorded depending on the specifics of the individual transactions. For further guidance on account transactions, numbers and definitions, please refer to USSGL Treasury Financial Manual (TFM) at http://www.fms.treas.gov/ussgl/tfm_releases/09-02/2010/part2_current.html .

Example of Practice

B1. The example of practice shown in the following table is for illustrative purposes only. The explanations and illustrations are presented to show how the standards may be applied but are not standards themselves. These illustrations are general in nature and may not apply to specific cases that appear similar but have unique circumstances.

B2. The table illustrates a federal entity's various actions that may be considered as evidence of its management's decision to either permanently remove, retire, and/or dispose of the asset or to retain the asset for future use (i.e., other than permanent removal from service).

B3. A federal entity would normally categorize assets that have been removed from service (i.e., use has been terminated) into one of the following three categories:

- retain asset for future use,
- set aside for future disposal, or
- imminent planned disposal.

B4. A federal entity would normally account for its G-PP&E in accordance with SFFAS 6 as well as the requirements for each category as established by the entity's policies and procedures. The following table outlines the processes the entity may undertake when preparing its G-PP&E for assignment to each of the categories. The actions outlined for categories 2 and 3 may be used as evidence of management's decision to permanently remove the asset from service, terminate its use and dispose of the asset. Once management's decision is identified, using scenarios in Table 1, the relevant financial accounting transactions can be determined and recorded.

Table 2: Illustrations of Management's Actions Demonstrating Decision for Other than Permanent or Permanent Removal/Retirement/Disposal When the G-PP&E is Not in Use

Actions Demonstrating Management's Decision	Category 1	Category 2	Category 3
	Other than Permanent	Permanent	
	Retain for Future Use G-PP&E is not in use	Set Aside for Future Disposal G-PP&E is not in use	Imminent Planned Disposal G-PP&E is not in use
Management			
Declare and report as "Vacant"	X	X	X
Declare and report as "Excess"		X	X
Expend maintenance, sustainment, and repair funds as needed to maintain a watertight asset	X	X	X
Conduct assessment to identify environmental issues		X	X
Complete required disposal documentation		X	X
Maintenance			
Maintain utilities in acceptable condition (i.e., fully functioning)	X		
Winterize plumbing (if required by local weather conditions)	X		
Conduct sufficient grounds maintenance to preclude unsightliness	X	X	X
Maintain security to prevent vandalism and unauthorized use	X	X	X
Retain equipment and spare parts[10] on asset	X		
Install equipment and conduct maintenance procedures required to preserve interior space	X		
Decommissioning			
Clean	X	X	
Dispose of excess personal property	X	X	X

Actions Demonstrating Management's Decision	Category 1	Category 2	Category 3
	Other than Permanent	Permanent	
	Retain for Future Use G-PP&E is not in use	Set Aside for Future Disposal G-PP&E is not in use	Imminent Planned Disposal G-PP&E is not in use
Turn off air conditioning		X	X
Maintain heat to prevent frozen pipes	X		
Disconnect utilities but maintain supply		X	X
Drain water		X	X
Disconnect utilities and remove supply		X	X
Remove air conditioning/heating units/plumbing fixtures for future use or disposal		X	X
Strip asset of attached equipment and spare parts for use on other assets		X	X
Remove all other fixtures and sell if salvageable		X	X
Dismantle asset		X	X
Remove contaminants if identified by environmental assessment.		X	X

[10]Examples of spare parts may include mechanical & electrical repair parts, electronic spares, maintenance assistance modules, and ready service spares.

Appendix C: Abbreviations

AAPC	Accounting and Auditing Policy Committee
FASAB	Federal Accounting Standards Advisory Board
G-PP&E	General Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

Appendix D: Glossary

Term	Definition
Excess[11]	The term "excess property" means property under the control of a federal agency that the head of the agency determines is not required to meet the agency's needs or responsibilities
Net Realizable Value[12]	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.
Obsolete[13]	PP&E no longer needed due to changes in technology, laws, customs, or operations.

[11]40 USC Section 102

[12]FASAB Consolidated Glossary: http://www.fasab.gov/pdffiles/codification_report2008.pdf

[13]*Derived from FASAB's definition for "Obsolete Inventory." See SFFAS 3, Accounting for Inventory and Related Property, par 29.*

Technical Release 15: Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation

Status

Issued	September 26, 2013
Effective Date	Effective upon issuance
Affects	None.
Affected by	Technical Release 17.

Summary

The implementation guidance promotes an understanding of organizational considerations that affect the application of the standards for general property, plant, and equipment (G-PP&E) except for internal use software. The implementation guidance relates to:

a) Recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the G-PP&E lifecycle, decisions regarding the granularity of cost information, and acceptable methods for recognizing those costs (i.e., capital costs captured on the Balance Sheet or period expense costs captured on the Statement of Net Costs [SNC]),

b) The concept of a cost accumulation and allocation decision framework (i.e., acceptable methods of accumulating, assigning, and reporting cost data), and

c) Management's role in applying the cost accumulation, assignment, and allocation decision framework.

One of the objectives of this Technical Release is to enable federal reporting entities to use a consistent framework to apply existing guidance. The guidance also supports the objectives of ensuring that transactions involving G-PP&E are recorded in accordance with federal accounting standards, and the cost of producing federal financial information, as it relates to establishing the cost of G-PP&E, does not outweigh the benefits derived by the users of the financial information. Lastly, it provides a decision framework flowchart to assist entity management in applying the principles described throughout the Technical Release.

Table of Contents

Introduction

Purpose

1. Statement of Federal Financial Accounting Standards 6 (SFFAS 6), *Accounting for Property, Plant, and Equipment*, (as amended) outlines the recognition requirements for general property, plant, and equipment (G-PP&E) except for internal use software. Paragraph 26 states that,

   "All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use."

   The AAPC G-PP&E Cost Accounting Issues Subgroup was developed to address a request for implementation guidance for these requirements.

2. The implementation guidance promotes an understanding of organizational considerations that affect the application of the standards for general property, plant, and equipment (G-PP&E) except for internal use software. The implementation guidance relates to:

   a. Recognition requirements for programmatic, managerial, administrative, and other elements of program costs[1] incurred during the G-PP&E lifecycle, decisions regarding the granularity of cost information, and acceptable methods for recognizing those costs (i.e., capital costs captured on the Balance Sheet or period expense costs captured on the Statement of Net Costs [SNC]),

   b. The concept of a cost accumulation and allocation decision framework (i.e., acceptable methods of accumulating, assigning, and reporting cost data), and

   c. Management's role in applying the cost accumulation, assignment, and allocation decision framework.

   In promoting an understanding of the standards it is important to reiterate management's responsibility to consider the six[2] qualitative characteristics of financial reporting established in Statement of Federal Financial Accounting Concepts (SFFAC) 1. More specifically,

[1]In this document, all subsequent references to these costs are collectively referred to as "program costs."

[2]Understandability, Reliability, Relevance, Timeliness, Consistency, and Comparability (SFFAC 1 paragraph 156)

management should be mindful of comparability when establishing policies and procedures. This framework should aid management in selecting policies which are comparable because they are derived from underlying transactions or organizational characteristics rather than being attributable to preferences.

3. The accounting standards and related basis for conclusions consistently recognize management's role in interpreting and applying generally accepted accounting principles (GAAP) (i.e., management's decision framework) to its respective entity's operational environment. The standards are meant to provide wide-ranging, reasonable, and consistent principles for reporting entities to operate within and to apply, respectively. For example, paragraph 3 of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, states, "These standards are based on sound cost accounting concepts and are broad enough to allow maximum flexibility for agency managers to develop costing methods that are best suited to their operational environment."

4. Consistent with "management's decision framework" (see Decision Framework Flowchart at **Appendix C**), this Technical Release is intended to reemphasize the "framework" aspect of the managerial cost accounting concepts and standards as they relate to G-PP&E cost accounting and reporting as outlined in SFFAS 6 and SFFAS 4.

Background

5. The Accounting and Auditing Policy Committee (AAPC) G-PP&E Cost Accounting Issue (CAI) subgroup was tasked with identifying and presenting recommendations to the AAPC to address the complexities of allocating program costs to G-PP&E consistent with the role of management's decision framework. This Technical Release (TR) addresses the following three central components of G-PP&E cost accounting and reporting:

   a. Recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the G-PP&E lifecycle, decisions regarding the granularity of cost information,, and acceptable methods for recognizing those costs (i.e., capital costs captured on the Balance Sheet or period expense costs captured on the Statement of Net Costs [SNC]),

   b. The concept of a cost accumulation and allocation decision framework (i.e., acceptable methods of accumulating, assigning, and reporting cost data), and

   c. Management's role in applying the cost accumulation and allocation decision framework.

6. The decision framework is intended to be used as a tool for management to leverage and guide professional judgment in the development and application of policies and practices to account for the cost incurred for G-PP&E in accordance with GAAP. Every entity has unique requirements and needs for financial management information to enable the successful execution of its mission and associated programs. Further, each entity needs varying levels of precision and granularity when allocating costs to end outputs or objectives. Therefore, each entity must assess and establish the appropriate cost benefit threshold for allocating program costs to G-PP&E in accordance with GAAP based on its mission requirements, operating environment, and stakeholder needs. The purpose of the decision framework is to provide guidelines and considerations, founded on a G-PP&E acquisition lifecycle approach, to guide management through the application of the G-PP&E accounting standards within their unique business environment. The decision framework incorporates the inherent application flexibility built into the accounting standards to assist management to reasonably apply the standards in order to appropriately recognize the cost of G-PP&E within their unique operating environment.

7. The decision framework discussed in this Technical Release recognizes that the financial management information needs of stakeholders, both internal and external, vary by entity depending on the entity's characteristics. An entity's revenue source (e.g., appropriated funds, revolving fund, user fee, etc.) significantly impacts the types of and level of cost detail required to be allocated to end assets. For example, entities operating under a fee -for-service or working capital fund structure may have a business need to accumulate and allocate relevant costs at a more granular level to ensure that their pricing models, rates and schedules facilitate the full recovery of costs under a non-appropriated, user-fee model.

8. The following three principles may be used by management to determine their stakeholder's financial management information needs:

   a. Relevance/usefulness of information (both to internal and external stakeholders);
   b. Level of precision (e.g., materiality) needed to properly manage and report costs; and
   c. Cost-benefit of establishing and executing cost assignment processes, methods and tools.[3]

   When applying the principles listed above, management should develop formalized policies and procedures documenting its decisions. Such decisions should be based on an understanding of the entity's mission and operating model and how the entity's stakeholders use the information.

[3]A [costing] method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users. (SFFAS 4 paragraph 142)

9. The decision framework described in the remainder of this Technical Release provides users with an organized approach for applying the principles described above to support their process for developing entity specific policies and procedures for accumulating, allocating, and reporting the cost of G-PP&E in compliance with relevant accounting standards.

10. Paragraph 10 was rescinded by Technical Release 17.

Materiality

11. 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.

Scope

12. Readers of this Technical Release should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. 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 clarifies but does not change guidance provided in SFFAS 4 or SFFAS 6 (as amended).

13. This Technical Release does not address Internal Use Software. (See instead SFFAS 10, *Accounting for Internal Use Software*.)

Summary of Existing Standards

14. SFFAS 6 Paragraph 26 states:

All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid [FN 16: "Interest costs" refers to any interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E.]

15. The types of costs assigned to G-PP&E may vary depending on if the asset is purchased as a completed item, is contractor constructed, or is self-constructed. SFFAS 6 specifically states that the costs recorded in G-PP&E should include only those costs that "bring the (G-) PP&E to a form and location suitable for its intended use." These costs may include both direct and indirect costs. However, indirect production costs only occur when G-PP&E are produced or constructed.

16. According to SFFAS 4, paragraph 90, "direct costs are costs that can be specifically identified with an output." [For purposes of this guidance "output" is an item or items of G-PP&E.] A few examples of direct costs noted in SFFAS 6, paragraph 26, are amounts paid to vendors, labor and other direct production costs, an appropriate share of the cost of the equipment and facilities used in the construction work, and direct costs of inspection, supervision, and administration of construction contracts and construction work. The direct costs accumulated and identified as costs incurred to "bring the G-PP&E to a form and location suitable for its intended use" should be assigned to the cost of the G-PP&E item(s). If the direct costs are not identified as costs incurred to "bring the G-PP&E to a form and location suitable for its intended use", then the costs should be expensed or capitalized in accordance with other standards. The item(s) of G-PP&E must meet or will meet the entity's capitalization threshold or other capitalization recognition criteria.

17. Indirect costs are costs that cannot be identified specifically with or traced to a given cost object in an economically feasible way [SFFAS 6, Glossary]. [For purposes of this guidance

"cost object" is an item or items of G-PP&E.] The example of indirect costs noted in SFFAS 6, paragraph 26, is indirect production costs (for assets produced or constructed). The indirect costs identified as costs incurred to "bring the G-PP&E to a form and location suitable for its intended use" should be accumulated, assigned or allocated to the cost of the G-PP&E item(s). If the accumulated indirect costs are not identified as costs incurred to "bring the G-PP&E to a form and location suitable for its intended use" (for example, administrative overheads that do not contribute to bringing the G-PP&E item to a form and location suitable for its intended use), then the costs should be expensed. Note also that if the item(s) of G-PP&E do not (or will not) meet the entity's capitalization criteria (e.g., capitalization threshold) then indirect costs are not a consideration.

18. A fundamental concept presented in this Technical Release is that it is reasonable to expect a difference in the level of granularity that federal entities use to allocate program costs to G-PP&E. Some entities have an inherent business/operational need to assign or allocate costs at a more granular level while others do not. This Technical Release emphasizes the concept that an entity management's role of establishing GAAP compliant policies and processes includes a critical element of flexibility. The flexibility allows management to create and execute policies and procedures that fit within the GAAP framework and align with the respective entity's business/operating model.

19. The below guidance is presented as responses to the three issues, previously identified in this Technical Release, posed as questions. Refer to Appendix D, *Accounting Literature* for a more extensive presentation of accounting literature relevant to this discussion.

Questions & Answers

20. Q1. SFFAS 6, paragraph 26, requires G- PP&E to be recorded at the costs incurred to bring the G-PP&E to a form and location suitable for its intended use. Examples of costs of acquiring G-PP&E are provided. Does management have discretion in applying the cost assignment methods identified in SFFAS 4, paragraph 124, to accumulate acquisition costs?

21. A1. Yes. SFFAS 4 establishes a principle for management to apply. Of particular importance is the emphasis on economic feasibility with regard to direct tracing of costs to outputs. SFFAS 4, paragraph 124, provides that "[in] principle, costs should be assigned to outputs in one of the methods listed below 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."

22. Each reporting entity should determine the appropriate detail for the cost accounting processes and procedures used to identify costs incurred to bring the G-PP&E to a form and condition suitable for its intended use per SFFAS 6, paragraph 26. The reporting entity should make this determination based on several factors, to include (SFFAS 4, paragraph 72):

    a. nature of the entity's operations;
    b. precision needed in cost information to meet managerial needs, including cost-recovery decisions;
    c. practicality of data collection and processing;
    d. availability of electronic data handling facilities;
    e. cost of installing, operating, and maintaining the cost accounting processes; and
    f. any specific information needs of management.

23. Q2. How should general management and administrative support be applied in considering the acquisition cost of G-PP&E?

24. A2. Management should consider general management and administrative support costs when identifying the costs to bring the G-PP&E to a form and location suitable for its intended use. Entities may incur indirect costs[4] that cannot be reasonably allocated to programs, segments, or outputs including G-PP&E acquisition. Because reporting entities have different organizational structures and missions, there will be differences in the level of allocation of such costs across all outputs including item(s) of G-PP&E. SFFAS 4, paragraph 92, explains that:

> A reporting entity and its responsibility segments may incur general management and administrative support costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization costs, and they should be reported on the entity's financial statements (such as the Statement of Net Costs) as costs not assigned to programs.

25. Q3. How does the principle of "non-production costs" apply in considering the acquisition cost of G-PP&E?

26. A3. SFFAS 4, paragraph 104, explains that:

> A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. Two examples of these non-production costs were discussed earlier: ?(1) Other Post-Employment Benefits

[4]Indirect production costs only occur when G-PP&E are produced or constructed.

(OPEB) costs that are recognized as expenses when an OPEB event occurs, and (2) certain property acquisition costs that are recognized as expenses at the time of acquisition. Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that are not accrued. Since these costs are recognized for a period in which a particular event occurs, assigning these costs to goods and service produced in that period would distort the production costs. In special purpose cost studies, management may have reasons to determine historical output costs by distributing some of these costs to outputs over a number of past periods. Such distribution may be appropriate when: (a) experience shows that the costs are recurring in a regular pattern, and (b) a nexus can be established between the costs and the production of outputs that may have benefited from those costs.

Non-production costs should not be assigned as G-PP&E acquisition costs, for instance, losses that arise from a natural disaster should not be attributed to G-PP&E acquisition costs even if the assets damaged are those being used to construct the G-PP&E. For example, if cranes used in constructing a building are completely destroyed in a hurricane, the cost of such damage should be treated as non-production costs and not as costs incurred to bring the building to a form and location suitable for use.

Summary of Illustrations

27. The decision framework supports development of accounting policies and practices appropriate to each organization's characteristics in accordance with GAAP. The framework is meant to provide parameters or principles for reporting entities to consider in developing organizational accounting policies and practices that will best support their operating models, provide the financial information necessary to manage programs, and report in accordance with GAAP. Reporting entities should report the full costs of outputs in the general purpose financial reports. Full costs may be expensed or capitalized in accordance with GAAP and based on each entity's accounting policies and practices.

28. This Technical Release provides examples of three different agencies applying the framework (**see Appendix B** for examples), which demonstrate GAAP compliant G-PP&E cost accumulation and allocation methodologies appropriate for unique organizational characteristics including operating models.

Effective Date

29. This Technical Release is effective upon issuance.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by AAPC members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In January 2008, the Accounting and Audit Policy Committee established the General Property, Plant, & Equipment (G-PP&E) task force to assist in developing implementation guidance for federal G-PP&E as it relates to SFFAS 6, *Accounting for Property, Plant, & Equipment,* SFFAS 23*, Eliminating the Category National Defense Property Plant, & Equipment*, and other related G-PP&E guidance developed by the FASAB. The task force includes federal agency representatives who are experiencing G-PP&E implementation issues and those who have G-PP&E implementation best practices to share with the federal community.

A2. The G-PP&E task force was divided into four subgroups to address a set of related issues. The subgroups have met separately to discuss their set of issues and report back to the full task force on its progress towards the development of implementation guidance. The four sub-groups are

- G-PP&E Acquisition
- G-PP&E Use
- G-PP&E Disposal
- G-PP&E Records Retention

A3. A fifth subgroup, the G-PP&E Cost Accounting Issues (CAI), was later added to address the complexities of allocating programmatic, managerial, and administrative costs to G-PP&E. The subgroup's primary objective was to reinforce the FASAB's provisions for Federal reporting entities to apply a reasonable level of management interpretation and flexibility, within the standards, to their G-PP&E financial recording and reporting processes. The subgroup's objectives did not include prescribing specific types of costs that should be included in the capitalized cost of an asset.

A4. This proposed guidance was developed by the CAI subgroup. The subgroup included industry representatives from several public accounting and consulting firms as well as representatives from the following federal agencies

- Department of Defense (DoD) (including the individual military departments)
- Department of Homeland Security (DHS)
- Federal Aviation Administration (FAA)
- General Services Administration (GSA)
- National Aeronautics and Space Administration (NASA)
- National Reconnaissance Office (NRO)
- Office of the Director of National Intelligence (ODNI)
- United States Bureau of Reclamation (USBR)

A5. The subgroup developed the Asset Acquisition Lifecycle Phases (AALP) data call for the task force member agencies' representatives to complete and submit to the subgroup for consolidation and discussion. The data call was designed to highlight the commonalities across the federal G-PP&E acquisition process and to use those commonalities to outline a general acquisition decision framework to assist agencies with accounting for G-PP&E costs in accordance with GAAP.

A6. The data call also focused on identifying the cost activities that occur in each AALP, the accounting treatments assigned to those activities, and the rationale for management's accounting policy that drives those cost accumulation and allocation determinations. Management's ability to document and implement a reasonable and consistent approach is a critical component of supporting management's application of GAAP.

A7. In reaching its conclusions, the subgroup recognized the need to develop implementation guidance to address the complexities of allocating programmatic, managerial, and administrative costs to G-PP&E. The subgroup felt that clarification of this issue is especially critical given the ongoing and significant efforts and resources that many federal entities such as the DOD, DHS, and IC are expending to obtain and maintain unqualified audit opinions. There are a number of cost beneficial and reasonable changes (e.g., policies, systems, and processes) that federal entities can and should make in order to facilitate better financial management and reporting. However, entity management must be allowed to navigate within the parameters of GAAP to determine the point at which the costs of improving or providing financial information outweigh the derived benefits.

A8. The decision framework discussed in this Technical Release recognizes that the financial management information needs of stakeholders, both internal and external, vary by entity. The agency-specific examples (detailed in Appendix B) demonstrate how G-PP&E cost accumulation methodologies may be tailored to different operating models and still be in accordance with GAAP. The implementation guidance does not provide a one-sized fits all solution, instead it is designed to give management a framework on which to base their stakeholder financial management information needs. The framework comprises the following three principles:

a. Relevance/usefulness of information (both to internal and external stakeholders);
b. Level of precision (e.g., materiality) needed to properly manage and report costs; and
c. Cost-benefit of establishing and executing cost assignment processes, methods and tools.

A9. One of the objectives of this Technical Release is to enable federal reporting entities to use a consistent framework to interpret existing guidance given the flexibility it provides. The proposal also supports the objectives of ensuring that (1) transactions involving G-PP&E are recorded in accordance with federal accounting standards, and (2) the cost of producing federal financial information, as it relates to establishing the cost of G-PP&E, does not outweigh the benefits derived by the users of the financial information. Lastly, it provides a decision framework flowchart to assist entity management in applying the principles described throughout the Technical Release.

Responses to the Proposal

A10. The AAPC received 15 response to the exposure draft from the following sources:

Table 1.0 - - Types of Respondents

	Federal (Internal)	Non-federal (External)
Users, academics, others		2
Auditors	0	2
Preparers and financial managers	11	

A11. The AAPC considered responses to the exposure draft at its July 11, 2013, public meeting. The AAPC did not rely on the number 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 AAPC considered the arguments in each response and weighed the merits of the points raised.

A12. Of the 15 responses, 14 supported the proposal. Of the remaining 1, offered comments.

AAPC & Board Approval

A13. The Technical Release was approved by the AAPC for release to the FASAB for issuance. The Board has reviewed this Technical Release and a majority of its members do not object to its issuance. Written ballots are available for public inspection at the FASAB's offices.

Appendix B: Illustrations

The examples in this Appendix are illustrative only; they do not represent authoritative guidance. These illustrations only depict a portion of the entities' operations and the inclusion of an illustration in this Technical Release does not mean the acceptance of the entities' policies by the FASAB or the AAPC.

Illustrations - Asset Acquisition Lifecycle Phases (AALP)

B1. The subgroup defined the AALPs to highlight the commonalities across the federal PP&E acquisition process and to use those commonalities to outline a general acquisition decision framework to assist agencies to account for G-PP&E costs in accordance with GAAP. Note that the AALP and illustrations reflect practices as of the Technical Release date and are not updated for changes that may have occurred since. The five generic AALPs are as follows: 1) Preliminary Research and Development (R&D) - Concept Exploration, 2) Intermediate R&D -Concept Development, 3) Advanced R&D - Concept Design and Development, 4) Production - Asset Development and "In-service" Placement, and 5) Operations and Maintenance. Table 1 (below) lists the five generic AALPs, for several task force member agencies' corresponding phases, the subgroup's AALP descriptions, examples of activities that may indicate transition from one AALP to another [phase indicators (examples)] and general accounting treatments that apply to activities in each AALP.

Table 1: Agency Summary Examples: Asset Acquisition Lifecycle Phases

Generic Subgroup AAPL Titles	Task Force Member Agency	Task Force Member Agency Phase Titles Used	Generic Subgroup AALP Descriptions
Phase 1: Preliminary R&D - Concept Exploration	**DoD**	Material Solution Analysis	Decision R&D activities directed at an identifiable current or emerging resource requirement(s).
	FAA	Mission Analysis Phase	
	GSA	Identification Phase	
	NASA	Pre-Formulation (Concept Studies)	
	NRO	Concept Studies	

Phase 1 Indicators (Examples): Concept, feasibility, and trade studies.
Phase 1 General Accounting Treatment: Expensed in the period incurred.

Generic Subgroup AAPL Titles	Task Force Member Agency	Task Force Member Agency Phase Titles Used	Generic Subgroup AALP Descriptions
Phase 2: Intermediate R&D -Concept Development	**DoD**	Technology Development	Targeted R&D activities that build upon the prior phase's Decision R&D activities and are directed at an identifiable current or emerging resource requirement(s).
	FAA	Investment Analysis Phase	
	GSA	Pre-Award Phase	
	NASA	Formulation (Preliminary Design and Technical Completion)	
	NRO	Concept Development	
Phase 2 Indicators (Examples): Investment analysis and review of alternatives. **Phase 2 General Accounting Treatment:** Expensed in the period incurred.			
Phase 3: Advanced R&D - Concept Design and Development	**DoD**	Engineering and Manufacturing Development	R&D closeout and the genesis of asset development activities.
	FAA	Solution Development	
	GSA	Award	
	NASA	Formulation (Preliminary Design and Technical Completion)	
	NRO	Preliminary Design	
Phase 3 Indicators (Examples): Source selection decision and approval for final investment analysis **Phase 3 General Accounting Treatment:** Mixture of costs that are expensed in the period incurred and those that are capitalized and depreciated or amortized over the useful life of the asset.			
Phase 4: Production - Asset Development and "In-service" Placement	**DoD**	Production & Deployment (P&D)	Fully-engaged asset development activities.
	FAA	Solution Implementation	
	GSA	Post-Award	
	NASA	Implementation (Final Design, Fabrication, Assembly, Integration & Test, Launch)	
	NRO	Build	
Phase 4 Indicators (Examples): Initiate asset development or acquisition. **Phase 4 General Accounting Treatment:** Capitalized and depreciated or amortized over the useful life of the asset.			
Phase 5: Operations and Maintenance	**DoD**	Operations & Support	Activities aimed at maintaining the operability of the entity's assets.
	FAA	In-Service Management	
	GSA	Operation and Maintenance	
	NASA	Implementation (Operation and Sustainment)	
	NRO	Operations	
Phase 5 Indicators (Examples): Asset is placed in service. Phase 5 General Accounting Treatment: Expensed in the period incurred (excluding costs incurred to extend the useful life, enhance existing capabilities, or add new capabilities to the asset).			

Agency Specific Examples: Asset Acquisition Lifecycle Phases

B2. A given entity may consider certain costs, such as the agency head's office, to be period costs because the activities contribute to the entity's strategic objectives and mission rather than the acquisition of a particular asset. In contrast, another entity may have an operational or business need to allocate the same type of costs to individual assets because such costs are incurred in support of acquiring those assets. Examples from the FAA, GSA, and the NRO are included in this Technical Release to demonstrate how an entity's operating model may affect how management identifies and records certain program costs.[5] The GSA's operating model requires more granular cost accumulation policies that allocate costs across the many individual assets it is responsible for acquiring. As shown in the following tables, this business need does not exist for the FAA or the NRO, where the mission is not primarily asset acquisition.

B3. The FAA's mission includes the modernization and improvement of the National Airspace System (NAS) and Research, Engineering & Development (RE&D) activities to improve the safety and effectiveness of the air traffic control system. To support its mission the FAA incurs direct (burden base) and indirect (burden pool) costs. The FAA has developed a burdening process by which management allocates indirect costs to various projects. For example, the FAA "pools" indirect technical support services contract (TSSC) and systems engineering and technical assistance (SETA) costs and uses its burdening process to allocate those costs to capital projects.

B4. A significant part of the GSA's mission is to serve as a supplier of goods and services to Federal agencies on a reimbursable basis. In this role, the GSA has a business need to capture costs (including overhead and indirect costs) at a very granular level. This permits the GSA to establish rates and develop pricing models that will recoup the full cost of operating under a non-appropriated, user-fee model. The difference in operational requirements results in GSA's personal property capitalization threshold of $10,000, which is lower than FAA and the NRO thresholds of $100,000. The GSA's personal property capitalization threshold is reflective of the types and quantities of property acquired by the GSA. This is an example of management's role in establishing internal policies and procedures that fit within the parameters outlined in GAAP and align to the entity's operating model.

B5. The NRO's G-PP&E cost accumulation and allocation policies and procedures allow the agency to meet the intelligence needs of the Intelligence Community (IC), Department of

[5]SFFAC 1 paragraph 164 states, comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices.

Defense, Department of Homeland Security, and users of intelligence products. Unlike the GSA, the NRO does not operate on a fee-for-service or reimbursable basis. The NRO utilizes cost-plus contractual agreements, which allows them to procure large scale satellite assets, as well as a wide range of professional and technical services that cross multiple PP&E assets and lifecycle phases. This acquisition and funding model contributes to an operating environment which results in a different decision point at which the benefits of achieving more precise cost allocation information are outweighed by the cost to obtain that information.

B6. The GSA has a business need to accumulate and allocate detailed cost information to ensure that their pricing models, rates and schedules facilitate the full recovery of costs under a non-appropriated, user-fee model. For GSA's real property construction and alteration projects, the cost object is a G-PP&E asset. In contrast, for the FAA and the NRO, the end program objective is enhanced information to meet a mission need. Each of these agencies utilizes their respective operating model as a component in the development and execution of their accounting policies and procedures. The G-PP&E cost accumulation policies and procedures of the FAA and the NRO are primarily related to their respective aerospace services and satellite-driven intelligence missions. The operating environments of these agencies are supported by low volume and high dollar value G-PP&E acquisitions. Consequently, these agencies have differing precision points at which accumulating and assigning costs to G-PP&E assets at a more granular level is ineffective and inefficient.

B7. The following examples describe the primary differences between these three agencies:

i. When a project meeting the capitalization threshold is deemed probable and feasible, the GSA will classify certain feasibility costs as eligible for capitalization. At the same time, the FAA and the NRO consider these costs to be period expenses.

ii. The GSA capitalizes direct labor cost and various types of allocable indirect labor costs associated with its capital projects. The FAA "pools" indirect TSSC and SETA costs and uses its burdening process to allocate those costs to capital projects.

iii. The NRO applies an allocation methodology to costs that are determined to be acquisition management costs (AMCs). AMCs include comingled government program management costs; costs associated with integration and support services provided on SETA, Federally Funded Research and Development Centers (FFRDC) and Contractor Assistance and Advisory Service (CAAS) contracts; directorate-level office support costs; and agency-level general and administrative costs. NRO's cost accounting system and processes do not facilitate direct tracing of AMCs and there is no inherent business or mission need to implement a system or reengineer processes that would do so. The NRO's allocation methodology capitalizes a portion of these AMCs to individual G-PP&E assets.

B8. Tables 2-4 provide a summary-level view of the GSA's, the FAA's, and the NRO's PP&E acquisition lifecycle cost accounting policies and procedures.

Table 2: General Services Administration

Phase	Activity	Recognition	Recognition Basis per Entity Internal Accounting Policies
1	Administrative Costs (Direct) of Developing & Fielding a System	Capitalize	**Pre-acquisition Costs.** Costs incurred prior to the formal project phase such as costs of feasibility studies, environmental studies, zoning and traffic studies, appraisals, surveys, and various planning and design costs may be capitalized if acquisition or approval of the project is probable and the costs can be directly identified to the project. If at a later date the project is canceled, then the previously capitalized costs are expensed.
2	Design Reviews (e.g., Formal Qualification Reviews, Preliminary And Critical Design Reviews): a. Before Technical Feasibility Has Been Determined. b. After Technical Feasibility Has Been Determined	a. Expense b. Capitalize	
3	Labor Costs During Construction (This includes the GSA's personnel and contract Direct Labor costs as well as Indirect costs allocated to capital projects.)	Capitalize	**Capitalized Projects.** GSA's real property policy capitalizes projects that acquire land and/or construct new buildings and structures; improve land; or extend the useful life of buildings and their systems; or replace, enhance or upgrade a substantial portion of an asset with additional functionality or capacity. For a project to be capitalized, it must: (1) have a cost of $50,000 or greater; (2) have a useful life of 2 years or more.
4	Project Management Costs - Baseline and Contractor Administration	Capitalize	
5	General Maintenance	Expense	The GSA considers the costs incurred in this phase inherently an expense.

Table 3: Federal Aviation Administration

Phase	Example Cost Activities	Recognition	Recognition Basis per Entity Internal Accounting Policies
1	Research & Development costs: • Mission Analysis • Identify Projected Demand for Services • Identify Technological Opportunities • Mission Needs Analysis and Assessment • Initial Requirements Definition	Expense	The FAA believes that the costs incurred in this phase are inherently expense.

Phase	Example Cost Activities	Recognition	Recognition Basis per Entity Internal Accounting Policies
2	Research & Development costs: • Investment Analysis • Initial Investment Decision • Final Investment Decision	Expense	The FAA expenses all prototype costs incurred before technological feasibility has been established except for operational feasibility prototypes that will be used in operations if successful..
3	• Solution Development • Program Management • System Engineering • Hardware/Software Design • Physical Airspace (PHYS/AIRSP) Infrastructure • Test and Evaluation • Data/Documentation	Comingled (i.e., Expense and Capitalize)	At the completion of a final investment decision the FAA makes the decision to acquire (develop or purchase) a G-PP&E asset. Based on guidance from the FAA financial manual certain costs will be capitalized and certain costs will be expensed. All qualifying costs necessary to acquire a capital asset, or improve on an existing capital asset, are classified as capital costs. The purchase price and costs incurred to bring an asset to a form and location suitable for its intended use are examples of capital costs. Costs that do not meet these criteria are expensed. The FAA expenses all costs incurred on a first prototype before technological feasibility has been established. After technological feasibility has been established, the subsequent costs of constructing and installing a first prototype are eligible for capitalization.
4	• Implementation • Program Management • Engineering • Environmental/OSHA • Site Selection • Construction • Install and Checkout • Commissioning/Close • Telecommunication • Training	Comingled (i.e., Expense and Capitalize)	See above (Phase 3).
5	• In-Service Management • Program Support • Second Level Engineering	Expense	At the completion of a joint acceptance inspection the asset is in a form and location suitable for its intended use. The FAA believes that the costs incurred in this phase are inherently expense.

Table 4: National Reconnaissance Office

Phase	Activity	Recognition	Recognition Basis per Entity Internal Accounting Policies
1	• Directorate Level Research and Development leading to the initial decision point (i.e., Key Decision Point A[6])	Expense	Basic, applied, and advanced R&D costs incurred prior to the secondary decision point (i.e., Key Decision Point B) are expensed.
2	• Costs related to the proposal review and contract award processes	Expense	Basic, applied, and advanced R&D costs incurred prior to Key Decision Point B are expensed.
3	• At Key Decision Point B the Director of the NRO signs a Decision Memorandum • Requirement and specification development • Labor costs during construction	Capitalize	Key Decision Point B triggers the capitalization of costs for development.
	• AMCs related to the program acquisition strategy management processes. These costs include: 1. Government program management costs, 2. Integration and support contracts for SETA, FFRDC, and CAAS, 3. Directorate level office support, Agency General and administrative costs	Comingled (Expense and Capitalize)	The NRO uses an allocation methodology by which Acquisition Management Costs (AMC) incurred throughout the entire acquisition lifecycle (excluding the Operations and Maintenance phase) are "bucketed" and allocated to capital and expense accounts based on the proportional percentage of actual, non-AMC capital and expense expenditures incurred throughout the year.
4	• Costs related to final design, build, test, and delivery activities	Capitalize	Development costs continue to be capitalized in this phase.
	• Project Management Costs - Baseline and Contractor Administration • AMCs related to the government program management processes	Comingled (Expense and Capitalize)	See AMC explanation in above Phase 3.
5	• Operations and Maintenance (O&M)	Expense	Initial operating capability (IOC) triggers the expense of costs for operations and maintenance.

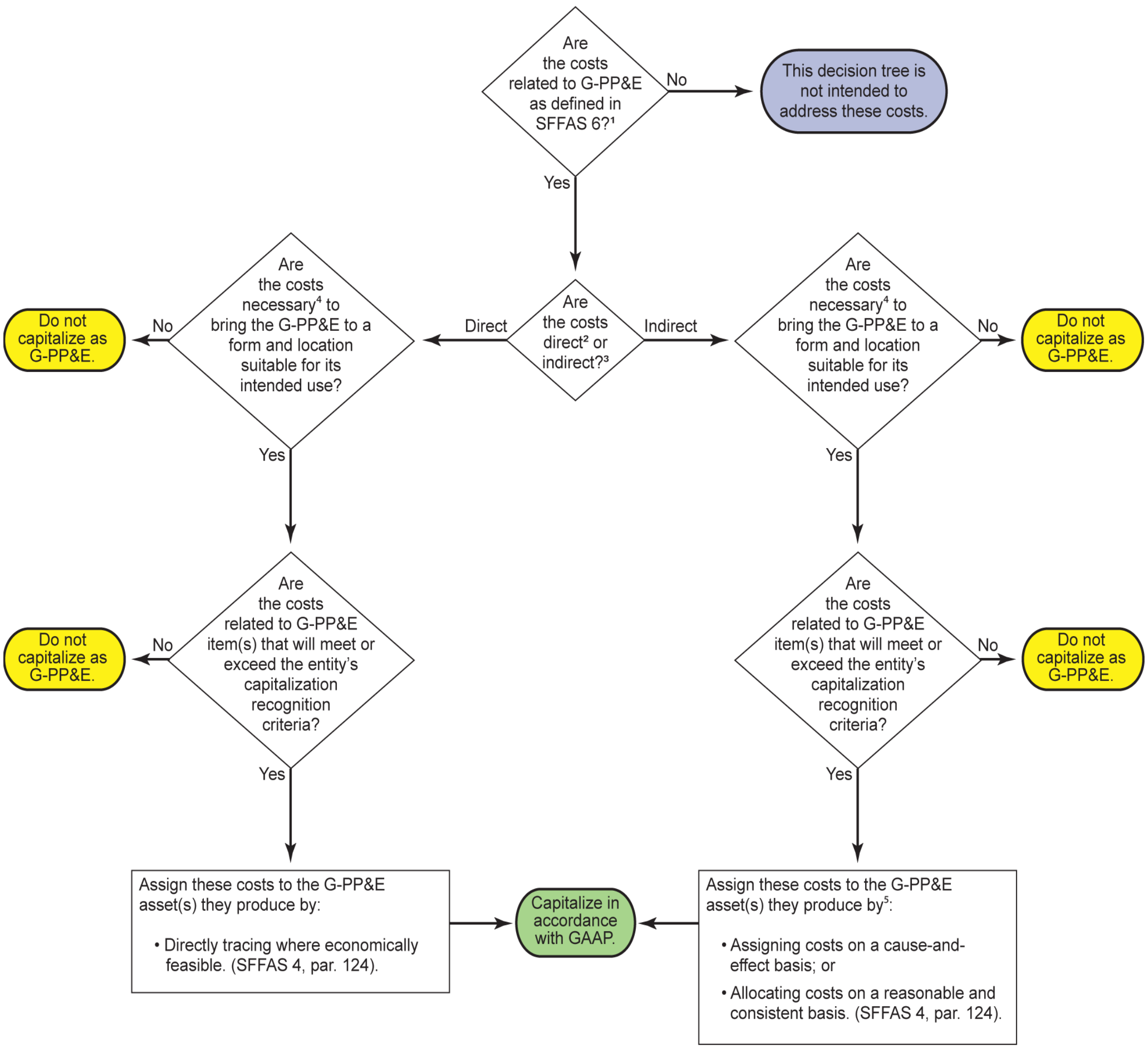
[6] Key Decision Points (KDP) are defined significant milestones in the National Security Space program of the Department of Defense acquisition lifecycle. For example, KDP B is the official program initiation of a National Security Space program of the Department of Defense, which triggers a formal review to determine maturity of technology and the program's readiness to begin the preliminary system design.

Appendix C: Decision Framework Flowchart

C1. As stated throughout this Technical Release, management should base their financial management information needs on the following three principles:

a. Relevance/usefulness of information (both to internal and external stakeholders);
b. Level of precision (e.g., materiality) needed to properly manage and report costs; and
c. Cost benefit of establishing and executing cost assignment processes, methods and tools.

C2. The decision framework flowchart provides users with an organized approach for applying the principles described above to support their process of developing entity specific policies and practices for accumulating, allocating, and reporting the cost of G-PP&E in compliance with relevant accounting standards.



[1] Refer to *SFFAS 6 paragraphs 17 and 23* for the definition of PP&E and specific characteristics of G-PP&E, respectively.
[2] 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. ***FASAB Handbook, Appendix E: Consolidated Glossary.***
[3] A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way. ***FASAB Handbook, Appendix E: Consolidated Glossary.***
[4] Refer to *SFFAS 6 paragraph 6* for a list of **examples** (i.e., not all inclusive) of costs that **may** (i.e., not prescriptive) be included in the full cost of G-PP&E.
[5] Consider:
- The relevance/usefulness of information to internal and external stakeholders,
- The level of precision needed to properly manage and report costs, and
- The cost-benefit of establishing and executing the alternative cost assignment processes, methods, and tools.

Appendix D: Accounting Literature

Recognition

D1. SFFAS 6 *Accounting for Property, Plant, and Equipment*, paragraph 26 provides the examples below as cost activities that reporting entities may incur in order to bring PP&E to a form and location suitable for its intended use. "For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid."

The Cost Assignment and Allocation Decision Framework

D2. Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements:* Statement of Net Cost (SNC) introduces the following components of the cost accumulation and allocation decision framework:

a. **Costs that cannot be assigned to specific programs or outputs** - Section II.4.4, "Statement of Net Cost", The "Components of Net Cost" subparagraph states that: "The statement should include a presentation of the following: (1) Program costs, (2) related exchange revenues, (3) the excess of costs over exchange revenues (net program costs), (4) gain/loss on pension, ORB, or OPEB assumption changes, (5) the costs that cannot be assigned to specific programs or outputs, and (6) the exchange revenues that cannot be attributed to specific programs and outputs.

b. **Program level versus output level cost allocation -** Section II.4.4.3 "Gross Program Costs" states that: The reporting entity should report the full cost of each program's output, which consists of (a) both direct and indirect costs of the output, and (b) the costs of identifiable supporting services provided by other segments within the reporting entity and by other reporting entities. The reporting entity should accumulate and assign costs in accordance with the costing methodology in SFFAS No.4. Program costs should also include any non-production costs that can be assigned to the program but not to its outputs.

c. **Costs not assigned to programs -** Section II.4.4.7 "Costs Not Assigned to Programs" states that: A reporting entity and its sub-organizations may incur: (a) high-level general management and administrative support costs that cannot be directly traced, assigned on a cause-and-effect basis, or reasonably allocated to segments and their outputs and (b) non-production costs that cannot be assigned to a particular program. These costs are part of the entity and sub-organization costs and should be reported on the SNC as "costs not assigned to programs."

Management's Role in Applying the Cost Accumulation, Assignment, and Allocation Decision Framework

D3. SFFAS 4 *Managerial Cost Accounting Standards and Concepts*[7] introduces the following components of the cost allocation decision framework:

a. **Appropriate and consistent cost accumulation, assignment, and allocation -** Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. 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.

The cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and effect basis, or (c) allocating costs on a reasonable and consistent basis.

[7] SFFAS 4 Text box above paragraph 116.

b. **Factors for management's consideration -** Each reporting entity should determine the appropriate detail for its cost accounting processes and procedures based on several factors. These include the:
- nature of the entity's operations;
- precision desired and needed in cost information;
- practicality of data collection and processing;
- availability of electronic data handling facilities;
- cost of installing, operating, and maintaining the cost accounting processes; and
- any specific information needs of management.

Appendix E: Abbreviations

AALP	Asset Acquisition Lifecycle Phases
AAPC	Accounting and Auditing Policy Committee
AMC	Acquisition Management Costs
ASID	Accounting System Identification
CAAS	Contractor Assistance and Advisory Service
CAI	Cost Accounting Issues
DHS	Department of Homeland Security
DoD	Department of Defense
FAA	Federal Aviation Administration
FASAB	Federal Accounting Standards Advisory Board
FFRDC	Federally Funded Research and Development Centers
GAAP	Generally Accepted Accounting Principles
G-PP&E	General Property, Plant, and Equipment
GSA	General Services Administration
IC	Intelligence Community
KDP	Key Decision Point
NAS	National Airspace System
NASA	National Aeronautics and Space Administration
NRO	National Reconnaissance Office
O&M	Operations and Maintenance
ODNI	Office of the Director of National Intelligence
OMB	Office of Management and Budget
OPEB	Other Post-Employment Benefits
ORB	Other Retirement Benefits
OSHA	Occupational Safety and Health Administration
PBS	Public Buildings Service
PHYS/AIRSP	Physical Airspace
PP&E	Property, Plant, and Equipment
RE&D	Research, Engineering & Development
R&D	Research and Development
SETA	Systems Engineering and Technical Assistance
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SNC	Statement of Net Costs
TSSC	Technical Support Services Contract
TR	Technical Release
USBR	United States Bureau of Reclamation

Technical Release 16: Implementation Guidance for Internal Use Software

Status

Issued	January 19, 2016
Effective Date	Effective upon issuance
Affects	Rescinds Technical Release 5.
Affected by	Technical Release 17.

Summary

This Technical Release (TR) assists reporting entities in implementing Statement of Federal Financial Accounting Standards *(SFFAS) 10, Accounting for Internal Use Software.* Since FASAB issued SFFAS 10 in 1998, software development practices have changed dramatically and reporting entities have experienced challenges applying the standards given the new terminology and techniques that have evolved. The TR provides implementation guidance regarding:

a. The definition of IUS, component/module based IUS assets, software development practices including approaches that involve phases, and clarifying IUS recognition, measurement, and disclosure items (such as capitalized cost, capitalization cut off, capitalization threshold, enhancement, impairment, and related matters);
b. New IUS challenges brought by changes in IUS development practices since the issuance of SFFAS 10; and
c. Management's role in applying SFFAS 10.

This objective of this guidance is to explain how to apply existing standards to the fast changing Internal Use Software (IUS) environment and help ensure that:

a. Transactions involving IUS are recorded in accordance with federal accounting standards.
b. The cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, does not outweigh the benefits derived by the users of the financial information.

Table of Contents

Introduction

Purpose

1. This Technical Release (TR) assists agencies in applying SFFAS 10, *Accounting for Internal Use Software*, to the new software development practices that have evolved since FASAB issued the standard in October 1998. The TR considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. Specifically, the TR provides guidance regarding:

   a. The definition of internal use software (IUS), component/module based IUS assets, software development practices including approaches that involve phases, and clarifying IUS recognition, measurement, and disclosure items (such as capitalized cost, capitalization cut off, capitalization threshold, enhancement, impairment, and related matters);

   b. New IUS challenges brought by changes in IUS development practices since the issuance of SFFAS 10; and

   c. Management's role in applying SFFAS 10.

2. This TR introduces new terms used in current development practices and defines them in light of the application of this guidance. It provides a discussion of issues and examples to assist entity management in applying the principles described throughout the TR. The examples were selected because they were derived from underlying transactions or organizational characteristics rather than being attributable to preferences.

3. The accounting standards and related basis for conclusions consistently recognize management's role in interpreting and applying generally accepted accounting principles (GAAP) within its operational environment. This TR recognizes that management is responsible for establishing IUS accounting policies, methodologies, and for maintaining adequate documentation on the sources of data. It also recognizes that the cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, should not outweigh the benefits derived by the users of the financial information.

Background

4. The software development life cycle has dramatically changed since the issuance of SFFAS 10 in 1998. At that time the linear/waterfall[1] software development practices were prevalent

[1] The waterfall model is a sequential design process, used in software development processes, in which progress is seen as flowing steadily downwards (like a waterfall) through the software development phases.

and characterized by three distinct life-cycle phases and long development cycles. Given the changes in development practices, technological advances, and significant new development techniques and architectures,[2] guidance for implementation and sustainment of SFFAS 10 became critical.

5. This TR introduces new IUS development terms and defines them to aid in applying existing standards. The definitions provided are not all encompassing but are included to promote greater understanding, and more consistent application and implementation of the standards. The same principles used to develop the guidance on the current IUS development practices could be used for future IUS development practices. The business events and deliverables table and agency practice examples are provided in Appendix B. These examples are intended to illustrate use of professional judgment in the development and application of policy and practices to account for IUS in accordance with GAAP. The examples are not all encompassing and reporting entities may identify other more useful and relevant methodologies. Users of this guidance should use these examples to develop their own reasonable business processes.

6. This TR was developed to aid in meeting the operating performance reporting objective identified in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, paragraph 14[3] : 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. Federal financial reporting should provide information that helps the reader to determine:

   a. The costs of providing specific programs and activities and the compositions of, and changes in, these costs;
   b. The efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs; and
   c. The efficiency and effectiveness of the Government's management of its assets and liabilities.

7. Paragraph 7 was rescinded by Technical Release 17.

[2] Such as cloud service, shared service, agile development, and spiral development with a focus on module based development and shorter development cycles.

[3] This principle was also relied upon in Office of Management and Budget (OMB) Circular A-11 *Preparation, Submission, and Execution of the Budget;* Supplement to Circular A-11, *Capital Programming Guide (July 2014),* Page 61.

Technical Guidance

Scope

8. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board.* This TR supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 4, 5, 6 (as amended), and 10.

9. This TR rescinds TR5 *Implementation Guidance on Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software*.

10. This TR applies to all internal use software that meet the definition of IUS as described in SFFAS 10 including the following:

    a. Software to be used in research and development where the software will have an alternate future use
    b. Software developed separately and installed on a number of different general property, plant, and equipment (PP&E) assets at different times[4]

Applying Existing Standards to Current Development Models

11. **IUS Definition:** SFFAS 10, paragraphs 8 - 9, defines "internal use software" as software that is "purchased from commercial vendors off-the-shelf (COTS), internally developed, or contractor-developed solely to meet the entity's internal or operational needs." The IUS development or modification can be performed by employees of the entity or contractors that the entity is paying to design, program, install, and implement. Software assets need to be evaluated for ownership to determine which entity is ultimately responsible for reporting the asset.

[4]SFFAS 10, paragraph 22, provides that 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. However, computer software could be developed separately and installed on several general PP&E assets at different times. For example, anti-ballistic missile software installed on multiple radar systems at different times can be treated as a separate IUS asset if the software meets the capitalization threshold.

12. **Development Phases:** SFFAS 10 presents three phases of software development that follow a linear approach to an IUS project: the preliminary design phase, the software development phase, and the post-implementation/operational phase. It states that costs incurred during the development phase should be capitalized, while the costs incurred in other phases should be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized or expensed based on provisions of SFFAS 10 and considering the substance of the activity.

13. Capitalized Cost: The full cost (direct and indirect cost as stated in SFFAS 4, paragraph 89, 90, and 91) incurred during the software development phases should be capitalized (SFFAS 10, paragraph 16 thru 18). Considering economic feasibility, a cost estimation technique could be developed to trace the costs to outputs based on the SFFAS 4, paragraph 124, provision that "[in] principle, costs should be assigned to outputs in one of the methods listed below 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."

14. A specific software development project may include expenditures for improvements and maintenance that cannot be easily separated but may be reasonably and consistently allocated. One approach that can be used is a ratio based on the projected work hours for development phase activities relative to other types of work. Such a ratio can be applied to determine the expenditures that should be capitalized. The basis for allocating costs should be consistent with applicable standards and defensible.

15. **Capitalization Cut Off:** SFFAS 10, paragraph 20, states, "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." In some development practices, each iteration[5] within an IUS development has its own acceptance testing before moving forward to the next iteration and final acceptance testing may not always be performed. The entity should identify a pre-determined agency milestone such as the go-live or in-service date which is equivalent to a final acceptance test for capitalization cut off purposes.

[5] Iteration is the act of repeating a process with the aim of approaching a desired goal, target or result. Each repetition of the process is also called an "iteration," and the results of one iteration are used as the starting point for the next iteration.

16. **Integrated Software:** SFFAS 10, paragraph 22, states, "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." 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 entity and is at the discretion of management of the entity. The rationale for this determination should be documented.

17. **Component Based IUS Asset:** SFFAS 10, paragraph 33, states, "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." For example, an entity may develop an accounting software system containing three modules: a general ledger, an accounts payable sub-ledger, and an accounts receivable sub-ledger. In this example, each module could be analyzed to determine whether it could be treated as a separate asset. Specifically, if the module provides economic benefit through distinct, substantive functionality; and meets the tests for capitalization threshold, ownership, and eligibility for capital treatment, then the module could be treated as a separate IUS asset for the purposes of recognition, measurement including amortization, and disclosure in accordance with SFFAS 10.

18. **Capitalization Threshold:** SFFAS 10, paragraph 24, states, "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." When establishing the capitalization threshold for IUS, the federal entity should include both qualitative and quantitative considerations as stated in SFFAC 2 paragraph 46. Qualitative considerations could be applied to IUS assets that require special management attention because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources. [6]

19. When establishing a capitalization threshold for bulk software purchases, the threshold should not be based on unit price. The organization should consider the bulk value and

[6]OMB Circular A-11 *Preparation, Submission, and Execution of the Budget; Supplement to Circular A-11, Capital Programming Guide, Threshold for Capital Programming,* page 2, July 2014.

useful life established by the organization to avoid materially distorting period costs and understating asset values.

20. OMB notes that a stratified capital programming process involving more or less detail and review based on the size or strategic importance of proposed investments may be appropriate, particularly in large agencies. [7] Similarly, more than one capitalization threshold could be established for different components of a large agency. Agencies should have well documented thresholds clearly disseminated and implemented across the organization.

21. **Enhancement:** SFFAS 10, paragraph 25, states, "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." Significant additional capabilities are modifications to existing IUS that result in additional functionality-that is, modifications to enable the software to perform tasks that it was previously incapable of performing. As stated in SFFAS 10 paragraph 26, capitalizable enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. Examples of enhancements could include augmenting existing business functions with new features and functions, developing additional new business functions, and/or adding new functionality and capability.

22. If one module is dependent upon another to function, then those modules should be evaluated together as one enhancement. All costs of an enhancement, including any costs carried over or allocated from the original software, should be amortized over the enhancement's estimated useful life.

23. **Impairment:** SFFAS 10, paragraphs 28-30, addresses how to determine if software is impaired during the post-implementation operational phases and the measurement of the impairment for the impaired software remaining in use or to be removed. Significant events or changes in operating circumstances warrant a review to determine whether the carrying value of an existing software asset is not recoverable and should be impaired. An assessment should be performed to determine the remaining useful life of the impaired software for amortization purposes.

24. When it is more likely than not that a developmental software project will not be completed, no further costs should be capitalized and any costs that have been capitalized should be written off in accordance with SFFAS 10, paragraph 31. Indications that the software may no longer be completed include:

    a. The expenditures are neither budgeted nor incurred to fund further development;

[7] See note 6.

b. The discontinuance of the business segment the software was designed for;
c. The inability to resolve programming difficulties timely; or
d. A decision to obtain COTS instead and abandon the current software development

25. When a developmental software project is suspended pending management's evaluation as to whether to resume or terminate the project, the software development cost may remain capitalized as long as it is more likely than not [8] that the developmental software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold. The status of the project should be reevaluated periodically and the capitalized cost should be written off if management concludes that it is more likely than not that the software will not be placed into service in the future.

26. **Software License:** If the term of software license(s) is 2 years or more with periodic payments, the license should be evaluated against lease criteria as stated in SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with an upfront cost[9] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its existing policy for capitalization thresholds to determine if the license should be capitalized or expensed.

27. A license agreement may include executory costs for maintenance and technical support. 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 amounts[10] 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. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance, and enhancement.

[8]SFFAS10, paragraph 31, provides for write off if it is more likely than not that the project will not be completed and placed in service.

[9]The cost could be charged as a one-time payment or financed over a set period of time.

[10]SFFAS 5, paragraph 44.

Guidance on Applying SFFAS 10 to Certain New IUS Developments

Cloud Computing

28. A cloud computing service is a resource provided over the Internet that has the following essential characteristics: on-demand self-service, broad network access, resource pooling, rapid elasticity, and measured service. The most common cloud service resources are: software as a service, platform as a service, and infrastructure as a service.[11]

29. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS 5 and SFFAS 6, and as discussed in paragraph 26 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform, or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform, or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.

Shared Services

30. Shared Service means a mission or support function provided by one business unit to other business units within or between organizations. The funding and resourcing of the service is shared and the providing entity effectively becomes an internal/external service provider. There are three types of shared service structures in the federal government: intra-agency, interagency and commercial. Intra-agency shared services include those provided within the boundaries of a specific organization such as a federal department or agency, to that organization's internal units. Interagency shared services are those provided by one federal oprovider's organizational boundaries. Commercial shared services are those provided by private vendors.[12]

[11]The full definition is available at The National Institute of Standards and Technology: *The NIST Definition of Cloud Computing,* Special Publication 800-145, September 2011.

[12]Chief Information Office Council: *Federal Shared Service Implementation Guide*, April 2013, and OMB M-13-08: *Improving Financial Systems Through Shared Services,* March 25, 2013.

31. For intra-agency shared services, a cost allocation methodology could be developed in accordance with SFFAS 4, paragraphs 120-125. For interagency shared services and commercial shared services, the service provider entity that owns (receives funding/responsible for maintaining) the software should account for the software in accordance with SFFAS 10. In the event that the entity receiving the service (the customer) has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software, then the customer should account for the software in accordance with SFFAS 10.

32. If the shared service arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of their other software licenses, as discussed in paragraph 24 of this TR. SFFAS 10 is not applicable to a shared service arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.

Agile Software Development Method

33. Agile software development method is a group of software development methods in which requirements and solutions evolve through collaboration between self-organizing, cross-functional teams. In an agile project, working software is deployed in iterations of typically one to eight weeks in duration, each of which provides a segment of functionality.[13] Initial planning regarding cost, scope, and timing is usually conducted at a high level, and the project status is primarily evaluated based on software demonstrations.

34. The IUS development phases listed in SFFAS 10, paragraphs 10-14, and within this TR could be applied to agile development projects on an iteration basis. If an iteration developed meets the module or component asset definition in accordance with SFFAS 10, paragraph 33, and as discussed in paragraph 15 of this TR, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the numbers of iterations are dependent on the outcomes of multiple processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

[13]Government Accountability Office: *Software Development Effective Practices and Federal Challenges in Applying Agile Methods*, July 2012.

Spiral Software Development Method

35. Spiral software development method combines the features of the waterfall and prototyping[14] incremental models, but with more emphasis placed on risk analysis and management. The spiral methodology projects are typically separated into phases like the waterfall method: planning, risk analysis, engineering, and evaluation. However, they are broken up into incremental releases of the product, or incremental refinement through each time around the spiral and through continuously analyzing the requirements and improving the definition and implementation. At each iteration around the cycle, the project is improved and extended. The release could be to an external or internal client, or to a partner.

36. The IUS development phases listed in SFFAS 10, paragraphs 10-14, and within this TR could be applied to a spiral development project on a process iteration basis. If an iteration developed meets the module or component asset definition in accordance with SFFAS 10 and as discussed in paragraph 15 of this TR, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the number of iterations are dependent on the outcomes of multiple spiral processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

Summary of Illustrations

37. The Business Events & Deliverables for Software Development Phases and the Common Agency Practice tables listed in Appendix B support development of accounting policies and practices appropriate to each organization's characteristics in accordance with GAAP. The tables are meant to provide examples for reporting entities to consider in developing organizational accounting policies and practices that will best support their operating models, provide the financial information necessary to manage programs, and report in accordance with GAAP. Reporting entities should report the IUS in the general purpose financial reports. Full costs of IUS development should be expensed or capitalized in

[14]The Prototyping Model is a system development method in which a prototype (an early approximation of a final system or product) is built, tested, and then reworked as necessary until an acceptable prototype is finally achieved from which the complete system or product can now be developed. This model works best in scenarios where not all of the project requirements are known in detail ahead of time. It is an iterative, trial-and-error process that takes place between the developers and the users.

accordance with GAAP and each entity's accounting policies and practices should support cost beneficial implementation.

Effective Date

38. This Technical Release is effective upon issuance.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by AAPC members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In June 2013, FASAB's AAPC established the IUS Task Force to assist in developing implementation guidance for IUS as it relates to SFFAS 10, Accounting for Internal Use Software and other related IUS guidance developed by the FASAB. The task force includes federal agency representatives who are experiencing issues with implementing SFFAS 10 and those who have implemented workable common practices to share with the federal community as well as industry representatives from several public accounting and consulting firms.

A2. During the initial phase of the project, the IUS task force divided into three subgroups to conduct research and explore the best approach for addressing current IUS issues within the federal community, including whether a TR should be developed, or revisions should be made to SFFAS 10. The subgroups met separately to discuss their assigned issues and report their research findings. The three subgroups were:

a. IUS Mapping Team
b. IUS Benchmarking Team
c. Standards Team

A3. After presenting the results of their research to the FASAB and AAPC, the task force concluded that implementation guidance would address the current IUS issues within the federal community. As a result, the AAPC endorsed the approach. The group held a re-entrance meeting on February 27, 2015 to re-engage agencies in drafting implementation guidance. This guidance focused on highlighting the common issues identified across the federal government IUS process, clarifying terminology, introducing new terms from the recent software development methodologies in light of application of SFFAS 10, and providing sample IUS practices adopted by the agencies. Based on the research, a TR would equip federal agencies with the knowledge and information needed to identify effective IUS practices that would in turn strengthen financial reporting in IUS area. It consists of two major topic areas:

a. Standards Clarification
b. Practical Examples of Implementation

A4. The IUS FASAB Task Force, which included industry representatives from several public accounting and consulting firms, as well as representatives from the following federal agencies, developed this proposed guidance:

a. Department of Commerce (DOC)
b. Department of Defense (DOD) (including the individual military departments)
c. Department of Health and Human Services (HHS)
d. Department of Homeland Security (DHS)
e. Department of Labor (DOL)
f. Department of Transportation (DOT)
g. Department of Treasury (Treasury)
h. Environmental Protection Agency (EPA)
i. Office of the Director of National Intelligence (ODNI)
j. United States Securities and Exchange Commission (SEC)

A5. Two subgroups were formed for standards clarification and best practices. The subgroups developed two data calls to highlight the commonalities across the federal IUS process. The first data call aided federal agencies in clarifying terminology and identified popular new IUS development items. The second data call highlighted IUS current practices adopted by the agencies and identified IUS development phase activities across the IUS development phases. The second data call also collected detail business events and typical deliverables during IUS development phases. Both data calls equip federal agencies with the knowledge and information needed to strengthen financial reporting.

A6. In reaching conclusions, the subgroups recognized the need to develop implementation guidance to promote an understanding of rapid changes related to software development practices that have evolved since the inception of SFFAS 10. The IUS task force views clarification of implementation and sustainment issues as critical given the new IUS challenges related to environmental changes and technological advances. There are several cost-beneficial and reasonable changes (for example, policies, systems, and processes) that federal entities can make to facilitate better financial management and reporting of IUS. However, entity management must be allowed to navigate within the parameters of GAAP to determine the point at which the costs of improving or providing financial information outweigh the derived benefits.

A7. This TR recognizes that the financial management information needs of stakeholders, both internal and external, vary by entity. The agency-specific examples (detailed in Appendix B) demonstrate how tracking costs to specific invoices may be tailored to different operating models and comply with GAAP. The implementation guidance does not provide a 'one-size-fits-all' solution; instead, it is designed to give management a tool on which to base stakeholder financial management information needs.

A8. When applying the principles listed in SFFAS 10, management should develop formalized policies and procedures documenting their decisions. Management is responsible for maintaining adequate documentation on the sources of data and the application of methodologies used when estimating cost.

A9. Implementation of SFFAS 10 and this guidance is a joint effort of an entity's Chief Finance Office and Chief Information Office. It is management's responsibility to provide for smooth communication between these two offices to foster an efficient and effective IUS implementation process.

Responses to the Proposal

A10. The AAPC received 12 responses to the exposure draft from the following sources:

Table 1.0 - Types of Respondents

	Federal (Internal)	Non-federal (External)
Users, academics, others		1
Auditors		1
Preparers and financial managers	10	
Total	**10**	**2**

A11. The AAPC considered responses to the exposure draft at its November 19, 2015, public meeting. The AAPC did not rely on the number 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 AAPC considered the arguments in each response and weighed the merits of the points raised.

A12. Of the 12 responses, nine supported the proposal. The remaining three offered comments. The AAPC made editorial changes suggested by the respondents.

AAPC & Board Approval

A13. The Technical Release was approved by the AAPC for release to the FASAB for issuance. The Board has reviewed this Technical Release and a majority of its members do not object to its issuance. Written ballots are available for public inspection at the FASAB's offices.

Appendix B: Illustrations

The examples in this Appendix are for illustration only; they do not represent authoritative guidance. These illustrations depict only a portion of the reporting entities' operations and their inclusion in this TR does not equate to policy acceptance, in whole or part, by the FASAB or the AAPC.

Illustrations B-1: Business Events and Deliverables for Software Development Phases

The table below provides examples of business events and deliverables which agencies may see within a typical software development life-cycle. The table is structured to follow the three software development phases as defined in SFFAS 10, paragraphs 11-14. When applying examples in this table to software development phases, the decision to capitalize or expense an item should be determined based on the nature of the cost activity when it is incurred, in accordance with SFFAS 10 paragraph 16 and as discussed in paragraph 12 of this TR: "It states that costs incurred during the development phase should be capitalized, while the costs incurred in other phases should be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized or expensed based on provisions of SFFAS 10 and considering their substance rather than their phase."

The table may be used as a sample guide for categorizing business events and deliverables during IUS phases, but it is not intended to be comprehensive. Each agency is responsible for developing policies and procedures that are appropriate for its specific environment and needs and may differ in content and order from the table below.

Business Event	Typical Deliverables
Preliminary Design Phase	
Formulation of Alternatives[15] [15] OMB Circular A-11 provides more information for alignment of agency IT investments with agency strategic plans.	
-Justification of investment need -Conceptual formulation of alternatives -Evaluation and testing of alternatives -Determination of existence of needed technology -Final selection of alternatives	Major Information Technology (IT) Business Cases, Capital Investment Decision Paper, Information Resources Management Strategic Plan, Enterprise Architecture Roadmap, IT Capital Asset Summary, Agency IT Portfolio Summary Submissions, Alternative of Analysis Report
Establish Project Governance	
-Identify and incorporate vision, roles, responsibilities, governance, organizations, and authorizations in project charter -Identify and document risks specific to project, including security risks -Establish and document quality control practices -Develop high-level estimates and schedule -Update discoveries and additional information	Project Charter, Project Action/Risk Register, Quality Management Plan, Project Schedule, Project Plan, Work Breakdown Structure
Determine Requirements	
-Develop high level list of functional and non-functional requirements -Obtain, review and document detailed business specifications for business requirements -Determine and document general data flows and interactions with other systems -Determine detailed business/system specifications to support requirements	Vision documents, Requirement Specification Document, Requirement Traceability Matrix, Process Flow Diagrams, Supplementary Specifications, Use Cases, User Workflow
Develop Software Development Plan	
-Create initial plan to define major releases of project and phases -Define configuration management practices -Define testing strategy for user acceptance, quality assurance and other necessary testing	Project Schedule, Release Specifications, Software Development Plan, Test Strategy, Quality Assurance (QA) Test Plan Risk Management Plan, User Interface Design Documents, Solution Design Document

Business Event	Typical Deliverables
Procurement	
-Create Request for Information (RFI) or Request for Proposal (RFP) for external vendor services or products -Evaluate and select externally provided services or products	RFI/RFP, Procurement Management Plan, Contract Statement of Work
Rapid Prototype/Pilot	
-Rapid prototype development and evaluation to refine requirements and prove concept -Pilot of proposed solution on small scale and over limited timeframe to prove concept and refine requirements -Update schedule and cost baseline based on discoveries from elaboration phase	Prototype (executable version of function and interface), Requirements Survey, Pilot program, Evaluation of Pilot, Scope Management Plan
Development Phase	
Software Development Initiation	
-Refine and execute practices for artifacts & configuration -Review work performed in prior iterative period, prioritize and assign work to be done in next iterative period -Coordinate updates to system inter-dependencies -Develop operations plan -Define and document architecture specifications -Develop and validate high value/high risk requirements of architecture components	Software Architecture Description Document, Software Development Plan, Iteration Plan, Operational Plan, Software Design Description
Rapid Development Risk Evaluation	
-Studies and analysis are performed during development environment to identify potential risks based on requirements & developed iteration	Risk identification and Mitigation Plan, Contingency Plan
Coding and System Design	
- Execute practices for version control of all software development artifacts - Create, design and modify system and associated hardware; coding and continuous refining. -Update project plan & business case -Add software development issues to the Issue Log to be prioritized and addressed -Conduct critical design review -Establish and document quality control practices	Software Architecture Document, Development Plan, Updated Project Management Documents, Issue Log, Critical Design Review Memorandum, Quality Management Plan

Business Event	Typical Deliverables
Testing	
-Identify tests and write test cases or scripts -Install hardware. Conduct unit and integration testing -Create operations manual and requirement documents for users -Document strategy and approach for system implementation (what will be deployed, where, and when) - Prepare turnover package to migration turnover and test readiness review and issue memo -Prepare detailed notes that describe the specific contents of a release for customer or outside testing party -Develop security test report and issue security certification and accreditation -Conduct user acceptance testing	Test Plan, Test Cases Scripts, Test Results, Operations Manual, Implementation Plan, Test Readiness Memorandum, Release Notes, Turnover Package, Transition Plan, Security Test Report, Security Certification and Accreditation, Security Test & Evaluation Plan, Software Architecture Document, Acceptance Test Plan, Acceptance Test Script
Readiness Review and Release	
-Conduct production readiness review and issue memo -Audit and project completion reports finalized -Issue operational readiness memo, certification of production, and final user acceptance testing memorandum	Production Readiness Review Memo, Transition Plan, Operational Readiness Memorandum, Audit and Project Completion Reports, Certification of Production, Final User Acceptance Testing Memorandum, User Manual, Operational Support Plan, Installation Plan
Post-implementation/ Operational Phase	
Deployment	
-Determine criteria for exiting transition phase controls have been identified and met -Stakeholder provides written approval that product meets documented business requirements -Revise and finalize detail Deployment/implementation plan	Update Project Management Documents, Scope Verification, Deployment/implementation plan
Training	
-Develop training delivery method, schedule, and plan -Develop training materials -Deliver training, record, and deliver webinars and communicate on-demand training	Training Plan, Training Materials, Training Delivery

Business Event	Typical Deliverables
Data Conversion	
-Development of software to facilitate data transfer or conversion -Develop data cleansing and transfer plan, including protocols for archiving legacy data -Perform activities to cleanse data and format for transfer -Perform mock migrations of data and analyze results -Perform final data migration and validation	Data Transfer Software, Data Transfer Plan, Formatted Data, Mock Migration Results and Analysis Report, Data Migration Validation Report
Operation and Maintenance Activities	
-Subsequent security accreditations (not included in user acceptance testing) -Software diagnostics -Repair processing and/or performance failures -Update documentation -Minor software updates -Minor corrections to design flaws	Accreditation Certification, Diagnostic Reports, Software and Process Documentation
Retirement of Software	
-Information preservation -Configuration management and control -Media sanitization -Hardware and software disposal	Disposal Certification

Illustrations B-2: Common Agency Practice

The common agency practice table highlights IUS practices adopted by the agencies in the areas identified by the IUS working group as common challenges. It intends to equip federal agencies with the knowledge and information needed to identify effective IUS practices and does not provide a ‘one-size-fits-all’ solution; instead, it is designed to give management some practical examples. Users of this TR should use the information provided in these examples to develop their own reasonable business processes. This table covers four areas of IUS development: 1) Identifying Cost, 2) Software Amortization, 3) Enhancement to IUS, and 4) Impairment to IUS.

Illustration Sample #1: Identifying Cost

Challenge Statement: Trace Development Cost to Specific Invoice		
Challenge Contributing Factors	**Task Force Member Agency**	**Agency Practice**
Cyclical development methodologies make differentiating between development and maintenance costs within an invoice difficult	A	Direct tracing or allocating the invoiced cost with the basis of estimate documented. Use status report or program/project documentation to evaluate activities and identify those that are development activities.
	B	Contractual requirement for vendor to provide a data item description deliverable with the estimate of costs between development and non-development activities along with each monthly invoice submitted.
	C	IUS cost primarily attributable to government labor hours. Quarterly report from the program offices detailing the employee or contract hours for each IUS project phase (preliminary design, development, or operational).
	D	Separate accounting lines used on purchase request and obligation document for development and non-development activity cost by coding every software project on a requisition. The captalizable requisition must be coded with general ledger account IUS-In Development in the accounting string which drives the purchase order and vouchers, thereby requiring the vendor to invoice in accordance with the activity breakouts.

Illustration Sample #2: Software Amortization

Challenge Statement: Timing of Commencement of Depreciation/Amortization		
Challenge Contributing Factors	**Task Force Member Agency**	**Agency Practice**
Obtaining evidence to support the determination of commencement of amortization	A	Open inter departmental communication facilitates decision to begin depreciation of software.
	B	A sign off document confirming key development milestones such as acceptance test are met.
	C	A certificate of production is issued communicating the software is in production and being utilized.

Illustration Sample #3: Enhancement to IUS

Challenge Statement: Define Enhancement to Internal Use Software		
Challenge Contributing Factors	**Task Force Member Agency**	
Determination of the significance of an enhancement to the IUS, incremental enhancement of capability, and the enhancement associated with new IUS development model	A	Defines enhancement to be the replacement, upgrade, modification, or addition of new features or capabilities to an existing system, product, tool, service, or infrastructure to improve its functionality. It involves a change in the capabilities, requirements, design, and/or architecture.
	B	Add additional capabilities and the enhancement costs are above agency's capitalization threshold. Repair a design flaw or perform minor upgrades that extend the useful life without adding capabilities, the costs are expensed and the useful life of the original asset is adjusted, as necessary.
	C	Enhancement cost exceed capitalization threshold, and when it is more likely than not that such enhancements will result in a significant increase in functionality that is apparent to the user. The cost of routine or minor changes or modernizations that do not significantly add functionality should be expensed in the period incurred. Examples of minor enhancement include updating data tables, web-enabling, customizing reports, or changing graphic user interfaces. Enhancements that may extend the useful life of the software without adding significant capabilities are to be considered minor and expensed.
	D	In Agile development model, enhancement follows the same capitalization criteria threshold for each release separately and tracks each version individually.

Illustration Sample #4: Impairment to IUS

Challenge Statement: Determination of Impairment for Internal Use Software		
Challenge Contributing Factors	**Task Force Member Agency**	**Agency Practice**
Determination of when the impairment is incurred without sufficient knowledge on the IUS operating status	A	Scenario-based impairment checklist reviewed on a quarterly basis to monitor impairment. The checklist examines the following scenarios: cessation of demand for the IUS asset, changes with an adverse effect on the IUS asset have occurred within the policy, legal or technological environment, plans to discontinue or restructure the IUS asset, the IUS asset is not performing as intended, and elements of the IUS asset functionality are not used as intended.

Appendix C: Abbreviations

AAPC	Accounting and Auditing Policy Committee
COTS	Commercial Off The Shelf
DHS	Department of Homeland Security
DOC	Department of Commerce
DOD	Department of Defense
DOL	Department of Labor
DOT	Department of Transportation
EPA	Environmental Protection Agency
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
HHS	Department of Health and Human Services
IT	Information Technology
IUS	Internal Use Software
NIST	National Institute of Standards and Technology
ODNI	Office of the Director of National Intelligence
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
QA	Quality Assurance
RFI	Request for Information
RFP	Request for Proposal
SEC	United States Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release
Treasury	Department of Treasury

Technical Release 17: Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment

Status

Issued	April 10, 2017
Effective Date	Effective upon issuance
Affects	Technical Releases 13, 15 and 16 are amended.
Affected by	None.

Summary

Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, amended SFFAS 6, *Accounting for Property, Plant, and Equipment*, and SFFAS 10, *Accounting for Internal Use Software,* and rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*.

This Technical Release (TR) provides amendments to previously issued TRs to acknowledge the rescission of SFFAS 35. It also clarifies that all standards-level implementation guidance for general property, plant, and equipment (with the exception of certain provisions applicable to internal use software) now resides in SFFAS 6, as amended.

Specifically, this TR provides conforming amendments to the following documents:

- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
- Technical Release 16, *Implementation Guidance For Internal Use Software*

This TR does not provide a complete update of the above TRs; the amendments conform the TR documents to the provisions of SFFAS 50. A separate TR will be issued that addresses SFFAS 50-specific implementation issues associated with the alternative methods of arriving at deemed cost.

The provisions of this TR 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.

Table of Contents

Technical Guidance

Scope

1. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

2. The amendments addressed in this TR conform the following documents to certain provisions established by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*:

   - Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
   - Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
   - Technical Release 16, *Implementation Guidance For Internal Use Software*

Amendments to Existing Technical Releases

Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*

3. This paragraph rescinds paragraphs 1-10 (including all section titles, subsection titles, and the accompanying footnote 1 to par. 3 contained within the introduction and background sections) of TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment.* This will eliminate potentially confusing references to the rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*, and amended portions of other Statements.

4. This paragraph amends the technical guidance section of TR 13 by inserting the subheading "scope" with paragraphs 10a-10c directly under "technical guidance" as follows:

Technical Guidance

Scope

10A. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.* This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

10B. SFFAS 6, *Accounting for Property, Plant, and Equipment*, (as amended) provides that reasonable estimates may be used to establish historical cost of general property, plant, and equipment (PP&E) in accordance with the asset recognition and measurement provisions within SFFAS 6. This is also applicable to internal use software when the software meets the criteria for general PP&E in accordance with SFFAS 10, A*ccounting for Internal Use Software.*

10C. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards* (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35, amended SFFAS 6 to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for general PP&E.

5. This paragraph further amends the technical guidance in TR 13 by inserting the subheading "effective date" with the following paragraph directly under the scope section added in paragraph 4 above as follows:

Effective Date

10D. This TR is effective upon issuance.

6. This paragraph amends the examples of practice provided in TR 13 by rescinding footnotes 2-4 of paragraph 12 and replacing paragraphs 11 and 12 as follows:

11. The examples outlined in this guide illustrate the use of various estimating methodologies to derive the historical cost of general PP&E in accordance with SFFAS 6, as amended. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended.[1A]

[1A]SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards* (SFFAS) 6, SFFAS 10, SFFAS 23, *and Rescinding SFFAS 35*, provides for deemed cost to be used for opening balances in some cases. Estimating historical cost is one of several deemed cost valuation methods. This TR addresses the estimation of historical cost and does not address other acceptable deemed cost methods.

12. Reasonable estimates may be based on

a. cost of similar assets at the time of acquisition;
b. current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or
c. other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

12a. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.

Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*

7. This paragraph amends TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*, by revising the last sentence of paragraph 12 as follows: "This Technical Release clarifies but does not change guidance provided in SFFAS 4, <u>or</u> SFFAS 6 <u>(as amended)</u>., ~~SFFAS 23, or SFFAS 35.~~

   The revised paragraph 12 of TR 15 is as follows:

   Readers of this Technical Release should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.* 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 clarifies but does not change guidance provided in SFFAS 4 or SFFAS 6 (as amended).

8. This paragraph amends TR 15, paragraphs 1 and 14, by updating it for the amended SFFAS 6, paragraph 26, language and adding "as amended" after SFFAS 6. The following language was added as the second sentence of SFFAS 6, paragraph 26: "Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein."

   The revised paragraph 1 of TR 15 is as follows:

   1. Statement of Federal Financial Accounting Standards 6 (SFFAS 6), *Accounting for Property, Plant, and Equipment,* (as amended) outlines the recognition requirements for

general property, plant, and equipment (G-PP&E) except for internal use software. Paragraph 26 states that,

> "All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. …."

The AAPC G-PP&E cost accounting issues subgroup was developed to address a request for implementation guidance for these requirements.

The revised paragraph 14 of TR 15 is as follows:

14. SFFAS 6 (as amended), paragraph 26, states:

All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid [FN30: "Interest costs" refers to any interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E.].

9. This paragraph rescinds paragraph 10 (and the preceding title "Related Accounting Literature") of TR 15.

Technical Release 16, *Implementation Guidance for Internal Use Software*

10. This paragraph rescinds paragraph 7 (and the preceding title "Related Accounting Literature") of TR 16, *Implementation Guidance for Internal Use Software*.

11. This paragraph amends TR 16, paragraph 8, by revising the last sentence as follows: "This TR clarifies but does not change guidance provided in SFFAS 4, 5, 6 (as amended), or 10.~~, and 35~~."

    The revised paragraph 8 of TR 16 is as follows:

    Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.* This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 4, 5, 6 (as amended), or 10.

Effective Date

12. This TR is effective upon issuance.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Committee members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Technical Release may be affected by later Statements or other pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Technical Release. Within the text of the Technical Release, the guidance sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statements or other pronouncements for the rationale for each amendment.

PROJECT HISTORY

A1. On August 4, 2016, the Federal Accounting Standards Advisory Board (FASAB or "the Board") issued SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35.* SFFAS 50 amended several Statements and rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*.

A2. As a result of these amendments and this rescission, all standards-level implementation guidance for general PP&E, with the exception of specific provisions applicable to internal use software, now resides in SFFAS 6, *Accounting for Property, Plant, and Equipment* (as amended). The Board concluded that providing implementation guidance for general PP&E other than internal use software in SFFAS 6 provides a comprehensive guide for users in a single Statement.

A3. During the due process of SFFAS 50, exposure draft (ED) respondents expressed concern about the rescission of SFFAS 35. These respondents relied on the guidance it provided and worried about audit issues that might result upon its rescission. TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*, remains in effect regardless of these amendments and this rescission.

A4. Comments received during due process of SFFAS 50 made it apparent that users rely on the technical guidance provided in TR 13 when developing reasonable estimates. Further, TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost*

Accumulation, Assignment and Allocation, provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the general PP&E lifecycle. TR 15 also provides illustrations and implementation guidance related to recognition requirements for decisions regarding the granularity of cost information and acceptable methods for recognizing those costs. Therefore, it was appropriate to ensure each significant provision of SFFAS 35 was incorporated in the amendments of TR 13, 15, and 16-including the ability to use estimates in the future.

AMENDMENTS TO EXISTING TECHNICAL RELEASES

A5. It was appropriate to update previously issued TRs to acknowledge the rescission of SFFAS 35 and that all standards-level implementation guidance for general PP&E (with the exception of certain provisions applicable to internal use software) resides in SFFAS 6 (as amended).

A6. The conforming amendments apply to the following documents:

- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
- Technical Release 16, *Implementation Guidance For Internal Use Software*

A7. The Accounting and Auditing Policy Committee (AAPC or "the Committee") concluded that it was appropriate to amend relevant sections of the TRs that discussed SFFAS 35 and other sections that referenced implementation guidance for general PP&E. The Committee removed certain language (from areas such as the introduction and background sections) because of the lengthy discussion and reference to the rescinded SFFAS 35 and portions of amended Statements. The Committee concluded that allowing the paragraphs to remain would be inconsistent with current references for generally accepted accounting principles and would lead to potential misapplication of the technical guidance.

A8. SFFAS 50 allows a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for general PP&E. A separate TR will be issued that addresses SFFAS 50 implementation issues associated with the alternative methods of arriving at deemed cost.

Summary of Outreach Efforts and Responses

A9. The ED titled *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment* was issued November 22, 2016, with comments requested by January 9, 2017.

A10. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News, the Journal of Accountancy,* Association of Government Accountants Topics, the *CPA Journal, Government Executive,* the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A11. The AAPC received seven responses from preparers, auditors, users of federal financial information, and professional associations. The majority of respondents agreed with the proposals in the TR.

A12. The AAPC considered responses to the ED at its February 9, 2017, public meeting. The AAPC did not rely on the number 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 AAPC considered the arguments in each response and weighed the merits of the points raised.

A13. Of the seven responses, six supported the proposal to acknowledge the rescission of SFFAS 35 and that all standards-level implementation guidance for general property, plant, and equipment (with the exception of certain provisions applicable to internal use software) now resides in SFFAS 6. One respondent neither agreed nor disagreed with the proposal. Further, of the seven responses, six did not believe there were additional amendments or issues that the AAPC should consider in this TR.

AAPC & Board Approval

A14. The TR was approved by the AAPC for release to the FASAB for issuance. The Board has reviewed this TR and a majority of its members do not object to its issuance. Written ballots are available for public inspection at the FASAB office.

Appendix B: Abbreviations

AAPC	Accounting and Auditing Policy Committee
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
G-PP&E	General Property, Plant, and Equipment
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

Technical Release 18: Implementation Guidance for Establishing Opening Balances

Status

Issued	October 2, 2017
Effective Date	Effective upon issuance
Affects	None.
Affected by	None.

Summary

Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment,* permits a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E).

This Technical Release (TR) provides additional guidance to those reporting entities in applying the alternative methods. This TR explains the alternative valuation methods in greater detail and describes examples of the acceptable types of documentation that may support the valuation as outlined in SFFAS 6, *Accounting for Property, Plant, and Equipment,* as amended. This TR does not provide guidance on the validation of the existence and completeness of general PP&E.

The alternative methods provided in SFFAS 50 are meant to be less costly options to implement generally accepted accounting principles when establishing opening balances for general PP&E. This TR acknowledges that the reporting entity may select any of the alternative methods and that there is no preferred method. Management is not required to select the most precise or best method.

While this TR is specific to reporting entities that apply SFFAS 50 or the alternative methods, there are additional TRs the reporting entity may find helpful and still apply. For example, TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*, addresses the estimation of historical cost, one of the deemed cost methods.

Materiality

The provisions of this TR 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.

Table of Contents

Technical Guidance

Scope

1. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

2. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, permits a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E). This TR provides additional guidance to those reporting entities in applying the alternative methods.

Alternative Methods

3. This implementation guidance provides assistance in applying the alternative methods for opening balances. It explains the alternative valuation methods[1] in greater detail and describes documentation that may support the valuation, as outlined in SFFAS 6, *Accounting for Property, Plant, and Equipment*, as amended. This TR does not provide guidance on validation of the existence and completeness of general PP&E.

4. In Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, the Federal Accounting Standards Advisory Board (FASAB or "the Board") acknowledges that accounting standards sometimes necessitate judgments about the cost and benefits of producing information or of reporting it differently. The standards-setter must, to some extent, be aware of these potential effects when considering the cost

[1]The Accounting and Auditing Policy Committee developed this guidance to explain the alternative valuation methods and describe the documentation that may support the valuation as outlined in SFFAS 6, as amended. Deemed cost (one of the alternative valuation methods) is also an acceptable valuation method for opening balances of inventory, operating materials, and supplies, and stockpile materials. SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials,* amended SFFAS 3, *Accounting for Inventory and Related Property*, to permit alternative valuation methods in establishing opening balances. Reporting entities may reference relevant portions of this guide when establishing opening balances in accordance with SFFAS 3, par. 20, 22-26, 42, 44, and 53, as amended.

and benefits of any given accounting alternative. The benefits of the standards should exceed the cost of applying them.

5. A premise for issuing SFFAS 50 was to consider the cost and benefit associated with establishing general PP&E opening balance information. As explained in the basis for conclusions of SFFAS 50, the Board made the following conclusions:

> A6. The Board noted that while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when FASAB issued many of these standards, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of this Statement is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed), but for which the current use is limited to accountability and assessing the cost of current services. The Board proposed less costly alternatives that will support this objective.
>
> A7. The Board believes assisting DoD with establishing a baseline benefits all parties. Providing a starting point will enable DoD to focus on needed improvements to systems and controls to process transactions going forward and thereby establish and maintain reliable financial information regarding future PP&E acquisitions. Establishing a sound financial management system is of primary importance.

6. The alternative methods provided in SFFAS 6, as amended by SFFAS 50, are meant to be less costly options to implement generally accepted accounting principles (GAAP) for general PP&E; this allows reporting entities to focus on needed improvements to systems and controls to process transactions going forward. By establishing and maintaining reliable financial information, such reporting entities will be more informed about costs of future general PP&E acquisitions.

7. The alternative methods provide the needed flexibility for establishing opening balances. At times, it is not practical or cost effective to determine the historical cost of general PP&E because of inadequate systems and/or insufficient documentation.

8. The alternative methods include (1) using deemed cost as an alternative valuation method for opening balances of general PP&E, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

Management Responsibility and Documentation

9. Management is responsible for establishing accounting policies, including the determination of which method to use. Any of the methods provided by SFFAS 6, as amended, are acceptable. It appears management would apply cost-benefit considerations and other

practical concerns under different alternatives. It is important to be mindful that the alternative methods for establishing opening balances are based on the concept of reasonable estimates and therefore do not seek precision.[2] Also, assessments of materiality and cost versus benefit should be guiding factors because cost-beneficial options are a major goal of SFFAS 50.

10. The reporting entity may select any of the alternative methods when establishing opening balances; there is no preferred method among those permitted. Therefore, making comparisons among the methods or attempting to identify the best method is inappropriate. Management should expect to provide adequate documentation that is consistent with the method used and supports the overall reasonableness of the valuation. However, management is not required to select the most precise or best method.

11. Management is also responsible for maintaining adequate documentation of data sources and the application of methodologies. It is reasonable to expect that sufficient, relevant and reliable historical cost information may not be available for general PP&E when applying the alternatives provided by SFFAS 50. In the absence of sufficient, relevant and reliable historical cost information on which to base the valuation, reporting entities should maintain supporting documentation for the alternative method and data used to establish opening balances. Management should expect to support alternative methods with auditable documented information. Adequate documentation of the source of the data and the application of the methodology used will help support management's assertion that the valuations are in compliance with accounting standards in all material respects.

12. The documentation should describe the methodology (alternative method used and description) and the reporting entity's review process to determine that the valuations are reasonable. While the documentation may differ from what is expected to support historical cost, it "should be complete and stand on its own." That is, a knowledgeable, independent person could perform the same procedures in the methodology and replicate the results. This should be maintained in a manner to facilitate the auditor's testing of the alternative methods. If the documentation were from a source that would normally be destroyed, then copies should be maintained for the purpose of reconstructing the amounts.

13. Additional information, including specific examples of documentation that may be acceptable, is included under each alternative method.

[2]As used in this document, "precision" refers to an exact amount that represents the one correct amount. This is in contrast to a reasonable estimate, which refers to an amount that is within a reasonable range of possible amounts, based on what is being measured.

Deemed Cost

14. The primary focus of this guidance is on the application of deemed cost. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for general PP&E. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 6, as amended, where historical cost information and systems do not support such balances.

15. Deemed cost may include several valuation methods because the reporting entity may have multiple component or subcomponent reporting entities[3] (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6, as amended, at different times prior to establishing opening balances. Large and complex reporting entities, such as the Department of Defense (DoD), may have used a variety of valuation methods.

16. It is acceptable for the reporting entity to have multiple component or subcomponent reporting entities that use various valuation methods simultaneously. Deemed cost should be based on one, or a combination, of the following three valuation methods permitted by SFFAS 6, as amended: (1) replacement cost, (2) estimated historical cost, or (3) fair value. While no disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required, documentation should clearly indicate the valuation method applied to each asset or class of assets.

17. While flexibility is offered, some options require additional disclosures,[4] such as when component or subcomponent reporting entities elect to apply alternative methods[5] besides deemed cost. SFFAS 6, as amended, provides that in the event a different alternative method is applied by a subcomponent reporting entity consolidated into a larger reporting entity, the alternative adopted by each significant subcomponent should be disclosed.

[3]SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

[4]See SFFAS 6, as amended, par. 40.h-i and SFFAS 10, par. 36.f-g for information about disclosures.

[5]As explained in par. 8, the alternative methods used to establish opening balances of general PP&E include (1) using deemed cost as an alternative valuation method for opening balances of general PP&E, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

18. Adoption of deemed cost includes various valuation methods that may require the use of assumptions to develop an approximate initial amount when there is no precise means of measurement.

19. There may be high uncertainty in the underlying assumptions used to establish opening balances under deemed cost methods. This guidance postulates that deemed cost will be subject to an inherent lack of precision because of the limitations regarding information available to the reporting entity. In using deemed cost, the reporting entity should consider the reasonableness of the assumptions selected, the relationship of the assumptions to the available documentation that is consistent with the methodology, and the overall reasonableness of the valuation.

20. This guidance provides a foundation for preparers to exercise judgment in developing surrogates for use as deemed cost. Unlike some judgments that management makes, deemed cost will not be "trued up" to reflect the actual value in the future. As addressed by SFFAS 50, deemed cost is a surrogate for the actual or historic cost associated with general PP&E, and there is no expectation the deemed cost will be updated or changed for the passage of time, except for error corrections. Said differently, when a reporting entity elects to adopt deemed cost to establish opening balances, the reporting entity establishes opening balances that are considered consistent with GAAP. The established opening balances are not expected to be updated at a later point in time (except for the recognition of the associated depreciation) or to be evaluated retrospectively.

21. The methods are described more fully below and not listed in order of preference.

Replacement Cost

22. Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life.[6] The use of replacement cost would be applied for valuing opening balances and not maintained through revaluation in the future.

23. SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, explains replacement cost and that there may be several ways of arriving at an approximation of it:

[6]SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46.

47. Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

48. The relevance of replacement cost is high, especially for assessments of financial position and future resource needs. The level of understandability, reliability, and comparability across entities of reported replacement cost amounts may vary according to the data used and the complexity of the calculation.

49. Reporting the replacement cost of capital assets used in providing services and related service costs can facilitate comparisons between program and activity costs and accomplishments related to the same period. An objection sometimes raised is that replacement cost is not an attribute of the asset that is actually owned. However, the asset being measured is not the physical asset but the services it can provide.

24. Generally, replacement cost is the amount that a reporting entity would pay to replace the service potential of an existing asset at current transaction prices with a similar asset. Replacement cost is different than reproduction cost. Reproduction cost is the cost to construct an exact duplicate of the structure at today's cost. Reproduction cost would result in reconstructing the item as is, using manufacturing/construction techniques and standards applicable at the time the asset (and any modifications) entered service. Replacement cost using today's materials and standards is typically lower than reproduction cost, as reproduction of older methods today is less efficient and more expensive.

25. As explained in SFFAC 7, a reporting entity must consider the remaining service potential or age of the general PP&E to arrive at replacement cost. For example, the cost of a new item of PP&E could be adjusted by the equivalent of accumulated depreciation based on the remaining useful life compared to the original useful life to arrive at replacement cost.

26. Under deemed cost, an effective managerial costing system that employs replacement cost information may be an acceptable source for replacement cost data.

Plant Replacement Value[7] One Acceptable Replacement Cost Method for Real Property)

27. Plant replacement value (PRV) represents the cost to design and construct a notional facility to current standards or to replace an existing facility at the same location. PRV was developed to support large-scale, program-level estimates for planning purposes and is used in the Federal Real Property Profile (FRPP).[8] While not previously used for financial reporting purposes, PRV is used for decision making and management purposes. PRV may be an appropriate starting point in establishing replacement cost for real property.

Figure 1: Plant Replacement Value Factors[9]

PRV = Facility Quantity x Replacement Unit Cost x Area Cost Factor x Historical Records Adjustment x Planning and Design Factor x Supervision Inspection and Overhead Factor x Contingency Factor

Source: GAO.

28. PRV is based on the factors identified in figure 1 above. The processes and methodology supporting the PRV model should be documented and maintained. To perform the calculation, the facility quantity (size or unit of measure, such as square footage) needs to be obtained for the real property asset. The replacement unit cost factors are derived from multiple sources, such as government-contract awards and commercial-estimating applications. Area cost factors are developed based on local conditions affecting construction costs. Actual contract award data may span multiple years due to the frequency of relevant awards. In collecting data for use in establishing area cost factors, timing issues will arise and some assets may take more than one year (often several) to plan, contract, and construct. Therefore, averaging the data represents a trade-off, but is acceptable. While more precision could be available, it might require a broader search for relevant cost data that may or may not enhance the resulting valuation.

29. PRV also includes historical records adjustment; planning and design cost factors; supervision, inspection, and overhead cost factors; and contingency cost factors. Because PRV will lead to a replacement cost value, the asset characteristics and factors included in

[7]Plant Replacement Value (PRV) may also serve as a basis to establish estimated historical cost. If so, adjustments for inflation/deflation may be appropriate.

[8]The FRPP is a "database of all real property under the custody and control of all executive branch agencies, except when otherwise required for reasons of national security." Federal Real Property Profile Management System. Accessed May 15, 2017. https://www.realpropertyprofile.gov/FRPPMS/FRPP_Login.

[9]PRV is not limited to the factors included in this figure and described in the following paragraphs. This is an example of one agency's model and factors. Other agencies may have different factors.

the model do not contain all possible attributes and factors associated with the actual asset. As noted in SFFAC 7 (par. 49), replacement cost is not an attribute of the actual asset; instead, it is the theoretical cost to replace the service potential embodied in the asset. Close alignment of the physical characteristics of the actual asset and the theoretical replacement asset is therefore not critical to arrive at a reasonable value.

30. Because of these inherent limitations, the PRV associated with a particular real property asset may not be indicative of all of the specific features of that asset. In fact, the specific features of the asset may not be consistent with current building codes, materials, or methods. Further, the specific characteristics of the asset may not be catalogued in sufficient detail to establish highly granular cost factors.

31. Potentially acceptable forms of supporting documentation[10] for PRV[11] or data elements include some or all of the following:

   a. A process to establish and verify the facility quantity

   b. Geospatial data and space management systems

   c. Maps with addresses or utilities

   d. Plot plans, as built blueprints, plats, and other schematics serving as facilities management documentation for the asset(s) in question

   e. State, city, and other municipality tax assessment documentation

   f. Designation letter

32. PRV is inclusive of capital improvements. For example, the primary sources of replacement unit costs are contract data and commercial estimating applications. Some of these factors are not explicitly addressed in PRV but are still embedded in the process. Further, the replacement-unit costs are intended to establish a notional amount for a large number of assets, rather than a specific asset. This representative amount is then applied to individual assets.

33. If PRV is used in establishing the opening balance for real property, then an adjustment for the difference in age between the existing asset and a replacement asset is required to

[10]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included in this list. The list is not exhaustive. Certain documentation would be more significant based on the PRV formula or other factors, but such assessments require judgment.

[11]PRV does not represent actual cost and is based on several factors that may be made up of different supporting documents, elements, and formulas.

arrive at replacement cost, per SFFAC 7, paragraph 47. This could be accomplished by recognizing accumulated depreciation based on the remaining useful life of the real property. Alternatively, other methods could be used to adjust the PRV for the difference between the remaining service potential of the asset and that of a new replacement asset. Statistical methods of approximating the remaining service potential may provide a cost-beneficial option for making such adjustments. This adjustment is unrelated to inflation or deflation since the acquisition of the existing asset.

Other Acceptable Replacement Cost Methods for General Property Plant & Equipment (PP&E)

34. There are several sources for current replacement-cost amounts for general PP&E. Potentially acceptable forms of supporting documentation[12] for this method include the information obtained from the following sources, guides, or lists:

    a. Published price list-the basic price of an item as published in a catalog, list price, or advertisement before any discounts are taken. If the price is reasonably current,[13] it may be used to establish replacement cost. Sources of price lists may include the following:

        i. The original equipment manufacturer

        ii. A vendor involved in the manufacture of the same or a similar asset

        iii. Federal Logistics Data (FED LOG) published by the Defense Logistics Agency (FED LOG prices may also serve as a basis to establish estimated historical cost.)[14]

[12] The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

[13] Reasonably current means that no material adjustments are required for changes in the general price level or for changes in specific prices.

[14] FED LOG may be a potentially acceptable form of supporting documentation unless unit pricing updates based on recent acquisitions and/or cost of living inflation factors are lacking. Assets listed in FED LOG will have a National Stock Number (NSN) or National Item Identification Number. FED LOG prices may also serve as a basis to establish estimated historical cost. Therefore, FED LOG is identified as a potentially acceptable form of supporting documentation under that discussion. In some situations, inactive acquisitions and older data may be indexed to derive estimated historical cost. In others, historical-cost information for certain types of assets (low-velocity items or major end items such as weapons systems or tanks) are likely to cover only the base asset value and not include later capital improvements or modifications. For example, when a major modification is made to a weapons system, typically a new NSN is created to differentiate the new capability from the older item. For example, FED LOG most likely will have an NSN for an Abrams M1A1 and a separate NSN for an Abrams variant M1A2. Therefore, flexibility must be allowed in determining if FED LOG can be used as replacement cost or estimating a reasonable historical cost.

iv. General Services Administration schedule

b. Published industry price guide-examples of such price guides include the Kelley Blue Book, Aircraft Blue Book, National Automotive Dealers Association guides, and Edmunds.com, which provide prices for the same or similar assets.

c. Values based on sales by the reporting entity of the same or similar assets to outside parties

Estimated Historical Cost (Initial Amount)

35. A reasonable estimate of historical cost may be based on one or more, or a combination, of the following methods:

    a. Cost of the same or similar assets at the time of acquisition

    b. Current cost of the same or similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index)

    c. Other reasonable estimation methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended

36. This list of reasonable estimates is not intended to establish any hierarchy of methodologies. As noted, reasonable estimates of historical cost do not require a precise measure of cost. Materiality and cost should be considered when weighing the benefits of greater precision.

37. Management is responsible for estimates included in the financial statements. Estimates are based on both subjective and objective factors and, as a result, judgment is required to estimate opening balances. Although reasonable estimates are applicable to any general PP&E, certain special considerations would be applied when establishing opening balances. The following is additional guidance that may assist in establishing opening balances based on a reasonable estimate of historical cost.

38. As noted, cost-beneficial options are a major goal of SFFAS 50. Estimating historical cost of an asset is not the same as recreating the accounting records that would have been created had the reporting entity undertaken a GAAP-accounting approach at the time the asset was acquired. SFFAS 50 is intended to avoid the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate

major acquisition/construction programs as they were executed), but for which the information's current use is limited to accountability and assessing the cost of current services.

39. Reporting entities must provide adequate supporting documentation appropriate for the deemed cost methodology selected to establish opening balances. SFFAS 50 and guidance clarified in this TR allows reporting entities flexibilities that should be considered when developing assumptions (see the next section) and documenting reasonable estimates of historical cost methodology.

Assumptions

40. Assumptions are basic beliefs about the future operating and functional characteristics.[15] For purposes of establishing opening balances of general PP&E, reasonable assumptions may be needed to make up for a lack of actual data. When reasonable assumptions are made, they should be documented and based on a consistent approach. Reporting entities should ensure that the assumptions are reasonable in the context of the asset, and that the overall valuation is reasonable.

41. Estimated historical cost is an estimate of the costs incurred to bring the PP&E to a form and location suitable for its intended use. SFFAS 6, as amended, paragraph 26, provides examples of the costs that may be included. When management opts to use "other reasonable estimation methods" (par. 35.c. above) such as budget records to estimate historical cost, this list is relevant.[16]

42. Many of the examples (such as direct costs of inspection, supervision, and administration of construction contracts and construction work) would require managerial cost accounting systems to calculate an appropriate capitalizable amount during the process of acquiring an asset. Including such costs in estimated historical cost would be especially challenging. The reporting entity may find that critical data elements are missing. For example, a reporting entity may utilize a contract for valuation of modifications even though the contract is missing one or more critical elements to allow for proper cost allocation.

43. The reporting entity should consider whether including all such costs is necessary or cost beneficial to arrive at a reasonable estimate. In doing so, the reporting entity may consider

[15]FASAB Handbook, Version 15 (06/16).

[16]Note that deemed cost methods other than estimated historical cost inherently include costs such as the costs identified in this list. Therefore, this list would not be relevant when management elects to apply methods identified at paragraphs 35.a. and 35.b.

whether comparable costs today are material. If material, management may elect to use current cost-accounting information to estimate historical costs of a similar nature. For example, if inspection and supervision costs are approximately six percent of contract costs today, then that may be a reasonable and cost-beneficial assumption about past costs.

44. Determination of whether to capitalize a particular cost as a cost of general PP&E should be based on general guidance in SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, and SFFAS 6, as amended. While these standards are imperative for the go-forward approaches implemented, it is difficult to apply these approaches in establishing opening balances under the alternative methods.

45. For example, SFFAS 4 provides that each reporting entity should accumulate and report the cost of its activities on a regular basis for management-information purposes and that costs should be assigned to outputs in one of the methods listed below in the order of preference:

    a. Directly tracing costs wherever feasible and economically practicable

    b. Assigning costs on a cause-and-effect basis

    c. Allocating costs on a reasonable and consistent basis

46. A reporting entity eligible to apply the provisions of SFFAS 50 has not been in compliance with SFFAS 4 or SFFAS 6 in the past. There may be little benefit in retrospectively establishing cost-assignment processes to capture indirect costs for the purpose of establishing opening balances. In addition, given that many assets may be near fully depreciated, there may be an argument to expense indirect costs based on materiality. These factors should be considered in developing the reasonable estimate.

47. The discussion below provides *examples* (that are not required or expected) of considerations that may be appropriate for a reasonable estimate of historical cost in establishing opening balances. The list below is not exhaustive and additional considerations (even if not specifically identified in the list below) may be necessary.

48. Considerations that may be appropriate for a reasonable estimate of historical cost in establishing opening balances include the following:

    a. It is a reasonable estimate; it does not seek precision.

    b. Materiality is a guiding factor in arriving at assumptions and the cost of more precise assumptions should be considered in relation to the materiality of their effect.

c. Multiple assumptions may be used to develop the reasonable estimate. This may include rates developed by other program offices, such as depot labor rates, maintenance, or other unique program rates that would be used for labor.

d. While conflicting documentation may exist regarding a particular item of general PP&E, the reasonableness of the estimate should be based primarily on the method selected. For example, deflating the current cost of a similar asset may result in an estimate that differs from a reasonable estimate based on budget records. Both estimates may be reasonable despite arriving at different amounts. The reporting entity is responsible for establishing a reasonable estimate, and it is not necessary to validate the estimate against alternative ways of arriving at it. The reporting entity should ensure its method is documented.

e. The deemed cost approach does not anticipate that the full series of entries related to general PP&E be recreated.

   i. For example, it would not be cost effective or beneficial to expect reporting entities to apply the full cost standards as they would have been applied[17] in establishing opening balances for general PP&E.

      1. Reporting entities may develop reasonable assumptions to determine the capitalizable portion of contract costs or pooled costs. An analysis of current contract costs, looking at the amount of capitalizable and non-capitalizable costs, may provide a reasonable proxy for historical experience. An analysis may provide for a certain percentage or to capitalize all costs of certain programs.

      2. Reporting entities may develop reasonable assumptions or methodologies to determine the capitalizable indirect costs for programs. An analysis of a few select programs may support that applying a set indirect rate to all remaining programs is reasonable.

[17]Conditions remain that existed when FASAB issued many of these standards, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of SFFAS 50 was to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed), but for which the current use is limited to accountability and assessing the cost of current services. The Board proposed less costly alternatives that will support this objective. (SFFAS 50, par. A6.)

Documentation

49. Traditional supporting documentation often was not available for legacy weapon programs. The reporting entity may have relied on other supporting documentation that may have been subsequently removed from the acquisition and/or asset management processes.

50. For example, third-party documentation[18] (such as congressional reports, cost documents, websites devoted to military weapon systems, historical newspaper articles referencing government sources, and other information obtained on the internet) and indexed appraisals may be considered acceptable. However, it is important that reporting entities document and maintain support for the data and assumptions used to develop reasonable estimates.

51. Examples of potentially acceptable documentation are included under each reasonable estimate method.

Estimates-Budget Based

52. The Budget of the U.S. Government (commonly referred to as the President's Budget) and related supporting documentation for a program or asset may have adequate detail to support a reasonable estimate. Specifically, the budget detail provides visibility of the various cost estimates for the program or asset by year. To ensure the full program and funding amounts have been reviewed, the amounts should be reconciled and documented at the appropriation level with Public Laws and allocated to individual programs based on information provided in pertinent budgetary documents. Examples of such budgetary documents may include the following:[19]

    a. Executive agency budget submission/request information

    b. Congressional conference committee reports

    c. House and Senate committee reports

    d. Congressional budget requests

[18] The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

[19] The examples of budgetary documents are not listed in any order of preference. They are examples and there may be others not included on this list.

e. Apportionment and Re-apportionment Schedule (SF-132) forms and Report on Budget Execution and Budgetary Resources (SF-133) forms

f. Other relevant documentation such as Department of the Treasury warrants, material supplemental appropriations, reprogramming, rescissions, transfers, or other budgetary documents that lead to a change in amount.

53. Although this method is relatively straightforward for individual assets or those recently acquired, it is much more complex when considering program or weapon systems that include a variety of assets and spare parts, logistics, and support equipment. The process is compounded when the information relates to assets, systems, and programs that date over 20 years or more.

54. Therefore, certain flexibilities should be afforded because reporting formats and information needs change over time. Examples may include the following:

a. Budget-based estimates may need to be reconciled to the documents listed in paragraph 52.a. - f., if available, or to alternative documents. Older assets (such as assets acquired in 1990 or before) and legacy systems may have different supporting documentation available.[20]

b. Budget documents in a summary format do not preclude a budget-based estimate; estimates may be made at the summary level when adequately explained.

55. Potentially acceptable forms of documentation for this method include the following:[21]

a. Budget justification materials and items discussed in paragraph 52.a. - f.

b. Appropriation data

c. Selected acquisition reports

d. P-1 documents and R-1 documents

[20]Reporting entities may use a Selected Acquisition Report, a congressionally mandated report for major weapon programs outlining budget projections. They may also use a P-1 document, which provides a breakout of all procurement appropriations by line item and an R-1 document, which provides a breakout of all research, development, test, and evaluation appropriations by program element.

[21]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

e. Program office analysis

f. Allocated per unit cost report

g. Technical specifications and estimates

h. Industry estimates reports of amounts to be expended

i. FED LOG[22]

Estimates-Contract Based

56. The best case scenario is a "conformed contract" providing all the information available that needs to be allocated to a particular asset, including all the modifications and delivery orders associated with the contract. However, this is not normally the case because costs to be capitalized are included in multiple contract line items and multiple contracts. This methodology involves valuing assets using the pricing data included in contracts. Although challenging, reasonable estimates based on contracts are still permitted.

57. Contracts contain specific contract line item numbers, which delineate specific production and non-production activities (for example, materials, installation, proposal prep, spare parts). As noted above, the determination of whether to capitalize a particular cost as a cost of general PP&E should be based on general guidance in SFFAS 4, and SFFAS 6, as amended. While these standards are imperative for the go-forward approaches implemented, it is difficult to apply these approaches in establishing opening balances under the alternative methods.

58. Potentially acceptable forms of documentation for this method include the following:[23]

a. Acquisition contracts

b. Time Compliance and Technical Orders (TCTOs)

c. Comprehensive Cost and Requirement System Reports

d. Program office delivery schedule

[22]See the FED LOG discussion on p. 10.

[23]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

e. Maintenance delivery schedule

f. DD Form-250, *Material Inspection and Receiving Report,* and other receiving reports

g. Invoices

h. Program office analysis

i. FED LOG[24]

Estimates-Engineering Document Based

59. Detailed technical and engineering documents lay out the assumptions, materials, and estimated cost to produce an asset. In these instances, the engineering documents can provide a sufficient basis for estimating deemed cost for opening balances.

60. Potentially acceptable forms of documentation for this method include the following:[25]

a. Technical specifications and estimates

b. Maintenance delivery schedule

c. Bill of material

d. Invoices

e. Vendor quotes on material costs/sale rates

f. TCTOs

g. Industry estimates

h. FED LOG[26]

[24]See the FED LOG discussion on p. 10.

[25]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

[26]See the FED LOG discussion on p. 10.

Estimate-Deflation of Current Cost

61. SFFAS 6, as amended, provides that general PP&E may be estimated based on current cost of the same or similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index). This method is appropriate when a series of similar items are being acquired over time and there is a reliable value for a base asset.

62. Considerable flexibility is permitted within the framework as long as the method is properly indexed. For example, estimation may extend beyond current costs, provided it is properly indexed. It may be possible that the cost of a similar asset listed in a price guide two years before or after acquisition, properly indexed, is a reasonable estimate and likely more accurate than an indexed cost taken from a current price guide.

63. Potentially acceptable forms of documentation for this method include the following:[27]

    a. Current cost of a similar asset
    b. Appropriate pricing index to discount the current asset cost to its estimated cost at the time of acquisition

        i. Consumer Price Index

        ii. Other indices from the Department of Labor's Bureau of Labor Statistics

    c. FED LOG[28]

Cost Estimators[29]

64. In certain instances, an informed opinion of an expert cost estimator may be used to support reasonable estimates consistent with the provisions of SFFAS 50 and this TR. Informed opinion refers to the judgment of others who make 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. If an expert cost estimator is used, the expert's credentials or qualifications should be articulated and

[27]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

[28]See the FED LOG discussion on p. 10.

[29]Cost estimators may also serve as a basis to establish fair value. Therefore, cost estimators are identified as a potentially acceptable documentation under that discussion.

documented in sufficient detail to allow review and validation by independent sources, including independent auditors. For example, reports and studies on relevant issues and other relevant communications describing the basis for any assumptions or changes in assumptions should be maintained in support of the expert's opinion.

65. Potentially acceptable forms of documentation for this method include the following:[30]

    a. Reports and studies

    b. Memos with outside experts and minutes from internal meetings describing the basis for any assumptions or changes in assumptions

    c. Previous studies conducted by the expert, including industry studies, journal articles, and third-party studies

Fair Value

66. Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.[31] When determining the value of opening property balances, fair value is an acceptable valuation method to use in absence of actual cost data and associated supporting documents.

67. FASAB has not developed detailed guidance regarding the approaches to use in establishing fair value. Other standards-setters have provided guidance. For example, the Governmental Accounting Standards Board (GASB) issued Statement No. 72, *Fair Value Measurement and Application*, which is summarized as follows:

> Fair value is described as an exit price. Fair value measurements assume a transaction takes place in a government's principal market, or a government's most advantageous market in the absence of a principal market. The fair value also should be measured assuming that general market participants would act in their economic best interest. Fair value should not be adjusted for transaction costs.
>
> To determine a fair value measurement, a government should consider the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes as provided by the accounting standards. For example, the unit of account for investments held in a brokerage account is each individual security, whereas the unit of account for an investment in a mutual fund is each share in the mutual fund held by a government.

[30]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

[31]SFFAC 7, par. 38.

This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required to replace the present service capacity of an asset. The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques should be applied consistently,[32] though a change may be appropriate in certain circumstances. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

68. SFFAS 6, as amended by SFFAS 50, permits use of fair value as one option for valuing opening balances and does not require that fair value be maintained through revaluation in the future. Generally, where fair value is applied in other circumstances it is maintained as a current value and updated each reporting period. Because SFFAS 50 seeks cost-effective approaches to a one-time valuation, the reporting entity should use fair value approaches that are cost effective. The data available should be appropriate to the circumstances of establishing a cost-effective opening balance for unique assets.

69. In such cases, the markets may be inherently limited given the unique nature of government assets, such as defense assets. In fact, many assets may be highly specialized, making fair value difficult to determine. For example, there may be few observable transactions and transactions may not be indicative of an active market between willing buyers and sellers.

70. 70.For these reasons, and to afford use of fair value in a cost-effective manner, opening balances at fair value may be determined based upon generally accepted approaches established by the GASB as well as

   a. market approaches where both the market and data are limited (hereafter "limited market approaches");

   b. cost estimators; and/or

   c. desktop appraisals.

[32]Cost-beneficial options are a major goal of SFFAS 50. The reporting entity may select any method; there is no preferred method among the methods permitted. The reporting entity should consider the reasonableness of the methodology selected and its relation to the available documentation. However, making comparisons among the methods or attempting to identify the most cost-beneficial method would be inappropriate. Management is not required to select the most precise or the best method.

71. Limited market approaches may include transactions under the foreign military sales program, prices charged for sales between federal government agencies, and other transfer programs for which reimbursement occurs.

72. Fair value can be established through an appraisal performed by an independent, qualified professional. The appraisal must be performed in accordance with the Uniform Standards of Professional Appraisal Practice to be considered compliant.

73. Although appraisals require the expenditure of resources, they may be justified for significant assets or when multiple, or groups of, assets can be appraised at the same time.

74. For the purpose of establishing deemed cost, desktop appraisals that do not require physical inspection of the assets are acceptable. Mass appraisals, which leverage systematic procedures and statistical testing techniques to value multiple assets concurrently, are also acceptable for establishing deemed cost.

75. Potentially acceptable forms of documentation for this method include the following:[33]

    a. Appraisal documents from qualified professionals

    b. Methodology describing the fair value process

    c. Documentation showing a recent sales transaction and amount for a similar asset in similar condition

    d. Documentation showing a third-party sales price for a similar asset in similar condition

    e. Documentation to support the cost estimator

Land Rights

76. One alternative method permitted under SFFAS 50 is an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

77. Reporting entities may elect to exclude land and land rights in establishing opening balances of general PP&E (consistent with the alternative method established in SFFAS 6,

[33]The forms of documentation are not listed in any order of preference. They are examples and there may be others not included on this list.

as amended, par. 40.f.i). It is important to consider what information should be disclosed regarding land rights.

78. SFFAS 6, as amended, states that a component reporting entity electing to exclude land and land rights from its general PP&E opening balances

> must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures. (SFFAS 6, as amended, par. 40.h.ii)

However, SFFAS 6, as amended, and the basis for conclusions for SFFAS 50, acknowledge the diverse nature of land rights. SFFAS 6 acknowledges that some land rights may be depreciable or amortizable while others are not. For example, land rights for a limited period of time are depreciated or amortized, whereas land rights that are permanent, such as with a deeded easement or right of way, are not.

79. The reporting entity should consider quantitative and qualitative criteria in determining if land rights disclosures of acreage are appropriate. A reporting entity electing to exclude land rights from the opening balances and to expense subsequent acquisitions of land rights would disclose acreage when a land right provides control of acreage. Generally, when a land right does not provide acreage to the entity (that is, by allowing the entity to control specific acreage), there would be no acreage to disclose. Therefore, there may not be land rights disclosures required by SFFAS 6, as amended, by SFFAS 50.

80. In addition, materiality is an overarching consideration in financial reporting.

Effective Date

81. This TR is effective upon issuance.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Committee members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Technical Release may be affected by later Statements or other pronouncements. The Handbook is updated annually and includes a status section directing the reader to any pronouncement that changed this Technical Release. Within the text of the Technical Release, the guidance sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statements or other pronouncements for the rationale for each amendment.

Project History and Guidance

A1. FASAB issued SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, on August 4, 2016, in response to DoD's request for guidance on establishing opening balances for general PP&E.

A2. The alternative methods provided in SFFAS 50 are meant to be less costly options to implement GAAP when establishing opening balances for general PP&E.

A3. In August 2016, the Accounting and Auditing Policy Committee (AAPC or "the Committee") approved two projects related to SFFAS 50. This guidance is a result of the AAPC's second project to develop timely implementation guidance to assist with issues related to SFFAS 50.[34] The AAPC established a task force to assist in developing the guidance. The task force comprised subject matter experts from outside the federal government (such as independent public accounting firms and consulting firms) and inside the federal government (such as chief financial officer staff and program office staff) to ensure diverse perspectives were represented.

A4. The AAPC task force was divided into sub-groups (general PP&E, land rights, and broad issues) to assist FASAB staff and expedite the identification of issues. The task force

[34]The first project resulted in conforming amendments to existing TRs. FASAB issued TR 17, *Conforming Amendments to Technical Releases for SFFAS 50*, *Establishing Opening Balances for General Property, Plant, and Equipment,* in April 2017.

considered draft documents prepared by FASAB staff. As a result of the task force input, FASAB staff developed the implementation guidance presented in this TR.

A5. This guidance applies to reporting entities electing to apply SFFAS 50. This TR provides additional guidance to those reporting entities strictly in applying the alternative methods in establishing opening balances.

A6. This implementation guidance assists in applying the alternative methods for opening balances and provides clarification on how the foundation and flexibility of SFFAS 50 encourage reporting entities to consider cost-benefit based on the availability of information or other practical considerations. It confirms that reporting entities may select any of the SFFAS 50 methods and there is no preferred method. Management is not required to select the most precise or best method.

A7. This guidance explains the alternative valuation methods and describes the documentation that may be used to support the valuation as outlined in SFFAS 6, as amended. This TR does not provide guidance on the validation of existence and completeness of general PP&E.

Summary of Outreach Efforts and Responses

A8. The exposure draft (ED), *Implementation Guidance for Establishing Opening Balances,* was issued June 21, 2017, with comments requested by July 21, 2017.

A9. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal, Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A10. The AAPC received six responses from preparers and users of federal financial information. The majority of respondents agreed with the proposals provided in the TR.

A11. The AAPC considered responses to the ED at its August 17, 2017, public meeting. The AAPC did not rely on the number 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 AAPC considered the arguments in each response and weighed the merits of the points raised.

A12. Of the six responses, four agreed with the proposals. Specifically, the respondents agreed that the TR provides clear technical guidance, clarifies the flexibility intended in selecting among methods by SFFAS 50, and explains that management is not required to select the most precise or best method. Two respondents neither agreed nor disagreed with the proposal. One respondent provided a letter indicating they had no comments. The other respondent provided editorial comments.

A13. Certain respondents provided suggestions and editorial comments. The respondents' comments were carefully considered by the Committee and several were adopted.

AAPC & Board Approval

A14. The TR was approved by the AAPC for release to FASAB for issuance. The Board has reviewed this TR and a majority of its members do not object to its issuance. Written ballots are available for public inspection at the FASAB office.

Technical Release 19: Rescission of Technical Release 8

Status

Issued	January 15, 2019
Effective Date	Effective upon issuance.
Affects	TR 8 is rescinded.
Affected by	None.

Summary

Statement of Federal Financial Accounting Standards (SFFAS) 55, *Amending Inter-entity Cost Provisions, amended SFFAS 4, Managerial Cost Accounting Standards and Concepts*, and rescinded SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4*, *Managerial Cost Accounting Standards and Concepts, and Interpretation 6*, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*.

As a result, Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs*, is no longer consistent with SFFAS 4, as amended, because the requirement to recognize inter-entity costs was revised significantly.

This TR rescinds TR 8 because it is no longer consistent with SFFAS 4, as amended.

The provisions of this TR 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.

Table of Contents

Technical Guidance

Scope

1. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

Rescission of Technical Release 8, *Clarification of Standards Relating to Inter-entity Costs*

2. This paragraph rescinds TR 8, *Clarification of Standards Relating to Inter-Entity Costs*, in its entirety because it is no longer consistent with SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* as amended.

Effective Date

3. This TR is effective upon issuance.

The provisions of this Technical Release need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Committee members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Technical Release may be affected by later Statements or other pronouncements. The Handbook is updated annually and includes a status section directing the reader to any pronouncement that changed this Technical Release. Within the text of the Technical Release, the guidance sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statements or other pronouncements for the rationale for each amendment.

Project History

A1. SFFAS 4 (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4),* required reporting entities to recognize the full costs of services received from other federal reporting entities even if there was no requirement to reimburse the providing reporting entity for the full cost of such services.

A2. The Federal Accounting Standards Advisory Board (FASAB) issued SFFAS 55, *Amending Inter-entity Cost Provisions*, on May 31, 2018. This Statement amended SFFAS 4 and rescinded SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4*, *Managerial Cost Accounting Standards and Concepts, and Interpretation 6*.

A3. With the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, as amended, were restored to their original language prior to the issuance of SFFAS 30. SFFAS 55 revised SFFAS 4 to provide for the continued recognition of significant inter-entity costs by business-type activities. Inter-entity costs continue to be imputed for those reporting entities conducting business-type activities[1] because the information is directly tied to rates.

A4. Per SFFAS 4, as amended, recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel

[1]Business-type activity is defined as a significantly self-sustaining activity that finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget (OMB). Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

Rescission of TR 8, *Clarification of Standards Relating to Inter-Entity Costs*

A5. This TR rescinds TR 8 because it is no longer consistent with SFFAS 4, as amended.

A6. Rescinding TR 8 rescinds guidance that is not in accordance with generally accepted accounting principles (GAAP) due to SFFAS 55 amendments. For example, TR 8 does not reflect that recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. However, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

A7. This TR also eliminates potentially confusing references to the rescinded SFFAS 30. The Accounting and Auditing Policy Committee (AAPC or "the Committee") believes it appropriate to rescind TR 8 because allowing it to remain is inconsistent with current GAAP and may lead to potential misapplication of the technical guidance. For example, paragraph 7 (the first paragraph under the "Technical Guidance" section) of TR 8 states: "This guidance is presented in response to three implementation issues identified by FASAB based on comments SFFAS 30 received from respondents." With SFFAS 30 being rescinded, allowing TR 8 to remain in effect could bring questions as to its applicability.

A8. Considering the changes that have occurred in the accounting for inter-entity costs, the Committee's goal was to update TR 8 to ensure clear guidance going forward. The Committee carefully considered if any guidance should be maintained and if any additional guidance was necessary. Paragraph 111 of SFFAS 4, as amended, states:

> Recognition of all significant inter-entity costs is important when those costs constitute inputs to government goods or services provided for a fee or user charge. Generally, the fees and user charges should recover the full costs of those goods and services. [Footnote 33 omitted] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold by the federal government. Recognition of inter-entity costs supporting business-type activities [Footnote 33A omitted] and recognition of inter-entity costs for non-business type activities that elect to do so should be made in accordance with implementation guidance provided by

FASAB through one or more Technical Releases.[33B] Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

[33B]Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs* provides implementation guidance. Additional TRs may be provided by FASAB if needed.

A9. The Committee believes that much of the guidance that was previously included in TR 8 is no longer necessary or relevant based on the amended standards. The purpose of TR 8 was to provide guidance in response to concerns raised during due process of SFFAS 30. TR 8 addresses three aspects of full costing specified in SFFAS 4: (1) guidance on costs that should be considered broad and general for all entities, (2) guidance on the directness of the relationship to the entity's operations as used in determining if a transaction should be considered material to the receiving entity, and (3) guidance on identifiability as used in determining if a transaction should be considered material to the receiving entity.

A10. The Committee determined that the list of broad and general support goods and services that was provided in table 1 of TR 8 is not necessary to maintain. While the list was helpful to the community when TR 8 was issued in 2008, the Committee believes the conclusions presented in the list are now well established and do not need to be included in any form of updated guidance. Table 1 provided the following examples, which appear to be widely understood in the community today as broad and general support goods and services:

a. Department of the Treasury services, such as disbursing electronic funds transfer and check payments, government-wide accounting and reporting policy and guidance, collection services, and trust fund maintenance

b. Department of Justice services, such as debt collection activities and non-reimbursed services for criminal and civil litigation

c. General Services Administration services, such as real and personal property disposal and central management functions

d. Department of Labor services, such as administration of unemployment compensation and non-reimbursable administration and support services for the Federal Employees Compensation Account

e. Office of Personnel Management services, such as administration of the Federal Employees Benefit Program (including pensions and post-retirement benefits)

f. Executive Office of the President, including all support functions performed

g. Government Accountability Office, such as accounting and auditing policy and guidance

A11. When considering the need for guidance on the directness of a relationship to an entity's operations, TR 8 included specific excerpts from respondents to SFFAS 30, which has now been rescinded. In addition, the guidance included excerpts from SFFAS 4 as well as paraphrases from the "Managerial Cost Accounting Concepts" and "Basis for Conclusions" sections that reiterated key points. While important, the Committee determined the following TR 8 topics discussed key points that reside in SFFAS 4, as amended, and do not need to be included in any form of updated guidance:

a. The directness of the relationship to entity operations is generally determined by matching goods or services received to the output of the entity.

b. Managerial cost accounting should be performed to measure and report the costs of each responsibility segment level's output.

c. The needs of the users of cost information must be taken into account.

A12. The Committee found that the majority of the explanations on identifiability included direct excerpts and paraphrases from the "Managerial Cost Accounting Concepts" and "Basis for Conclusions" sections from SFFAS 4. The guidance in TR 8 related to the requirement for the provider to supply the receiving entity with information on the full cost of non-reimbursed or under-reimbursed inter-entity goods and services. The Committee believes this requirement and the requirements when information is not provided are well understood by the community. Therefore, this does not need to be included in any form of updated guidance.

A13. In summary, the Committee believes that, while the guidance was useful during initial implementation of SFFAS 30, it is no longer necessary. Much of the guidance provided in TR 8 is now understood by the community. Further, portions of TR 8 reiterated key points from SFFAS 4 and quoted it directly. Other portions of TR 8 contained paraphrases from the "Managerial Cost Accounting Concepts" and "Basis for Conclusions" sections of SFFAS 4 that are still included within SFFAS 4. For example, including excerpts from SFFAS 4 (issued in 1995) is not practical or useful considering SFFAS 4 is available for reference. The Committee believes all necessary guidance resides in SFFAS 4, as amended.

Summary of Outreach Efforts and Responses

A14. The exposure draft (ED), *Rescission of Technical Release 8*, was issued August 21, 2018, with comments requested by October 5, 2018.

A15. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal, Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A16. The AAPC received nine responses from preparers, users of federal financial information, and professional associations.

A17. The AAPC considered responses to the ED at its November 27, 2018, public meeting. The AAPC did not rely on the number 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 AAPC considered the arguments in each response and weighed the merits of the points raised.

A18. All respondents supported the proposal to rescind TR 8, *Clarification of Standards Relating to Inter-Entity Costs*, because it is no longer consistent with SFFAS 4, as amended.

AAPC & Board Approval

A19. The TR was approved by the AAPC for release to FASAB for issuance. The Board has reviewed this TR and a majority of its members do not object to its issuance. Written ballots are available for public inspection at the FASAB office.

Appendix B: Abbreviations

AAPC	Accounting and Auditing Policy Committee
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

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.
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.

Table Of Contents

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.

The provisions of this Staff Implementation Guidance need not be applied to immaterial items.

Staff Implementation Guidance 31.1: Guidance for Implementation of SFFAS 31, *Accounting for Fiduciary Activities*

Status

Issued	March 19, 2009
Effective Date	Effective upon issuance.
Affects	SFFAS 31
Affected by	None.

Summary

This implementation guidance addresses questions on implementation of SFFAS 31, *Accounting for Fiduciary Activities* that were raised by federal preparers.

Table of Contents

Background

1. After the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 31, federal preparers had questions about its implementation. The below Staff Implementation Guidance (SIG) Q&As address questions that were raised by federal preparers.

2. SIG does not establish new requirements. Rather, SIG is intended to assist preparers in the application of FASAB literature.

Staff Implementation Guidance

3. **Q 1: Do the requirements of Statement of Federal Financial Accounting Standards (SFFAS) 31 extend to all reports required by law or administrative action?**

4. No. SFFAS 31 explains the scope of the standards as follows:

> SFFAS 31
>
> [8] This statement provides financial reporting standards for fiduciary activities in the general purpose financial statements for Federal entities. The standard does not affect reporting in the Budget of the United States or special-purpose reports.

5. Accordingly, SFFAS 31 does not apply to (a) reports such as stand-alone audited financial statements that are prepared under an "other comprehensive basis of accounting" (which may be considered "special purpose reports") or (b) individual statements provided to beneficiaries.

6. With respect to individual statements to beneficiaries, some have suggested that the SFFAS 31 disclosures should be based on information prepared at the beneficiary ownership level and aggregated for the component entity. Component entities using this approach would develop and report accrual basis information for the individual beneficiary. The Board does not intend that this approach be required. Rather, the Board intends the accrual of fiduciary activities to be implemented in a cost-effective manner. Therefore, a single aggregate accrual that supports information presented in the schedule of net assets and fiduciary activity in a note to the financial statements should be considered. This approach would support the disclosures required by SFFAS 31 in a cost-effective manner.

7. **Q 2: May component entities aggregate fiduciary activities for disclosure purposes?**

8. Yes. Further, discretion is permitted in selecting activities to be presented individually.

9. SFFAS 31 provides:

> SFFAS 31
>
> [20] For component entities with several distinct fiduciary activities, summary financial information required in paragraph 18 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 21) may be aggregated.
>
> [21] Selecting fiduciary activities 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 fiduciary net assets or inflows; and qualitative factors such as whether a fiduciary activity is of immediate concern to beneficiaries, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the fiduciary note disclosure would be the primary source of financial information for the public.

10. Paragraph 20 of SFFAS 31 identifies the summary financial information that should be provided for each fiduciary activity presented individually and explains that this financial information should be presented as aggregated for all activities not presented individually. Paragraph 21 of SFFAS 31 recognizes that judgment should be exercised in deciding if any fiduciary activities should be presented individually. For example, subject to the considerations in paragraphs 20 and 21, an entity might present summary financial information for:

    a. all fiduciary activities in aggregate,

    b. fiduciary activities aggregated by type of activity such as leasing or investing activity,

    c. classes[1] of beneficiaries separately as individual fiduciary activities, or

[1]Beneficiaries may belong to a class if they are (1) served by the same system or program office, (2) share certain traits or characteristics (e.g., local governments), or (3) both.

d. fiduciary activities conducted by individual program offices.

11. The entity may present simply "total fiduciary funds" as a single column. Alternatively, the entity may present the information by program office to facilitate performance measurement. Yet another option is to present information by class of beneficiary.

12. Q 3: In some cases several bureaus within an agency or department perform activities that result in fiduciary balances that are distributed by another bureau of the agency. Should each bureau include fiduciary activities disclosures in its stand alone audited financial statements?

13. If the activity meets the definition of fiduciary activity it should be disclosed as such in each bureau's stand alone audited financial statements. (See paragraph 5 of this document for clarification regarding special purpose reports.)

14. Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest[2] that the Federal Government must uphold.

15. For an activity to meet the definition of a fiduciary activity, the Federal entity has to:

a. collect and receive fiduciary cash or other assets and subsequently

b. perform one or more of the other activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

16. Q 4: In some cases, beneficiaries may direct third parties to make payments to a federal agency for credit to the beneficiaries' account. For example, the beneficiary may hold assets outside the trust and elect to liquidate the assets and have the proceeds deposited in the trust. At what point does this activity result in an asset that qualifies for disclosure as fiduciary activity?

17. The role of the federal entity must be understood in order to determine the extent of the fiduciary disclosure requirement in SFFAS 31. In some cases, there is no fiduciary or trust asset until an actual deposit is received. If, for example, the federal component entity has no collection responsibilities but merely receives funds directed to the entity by the

[2]The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation. (SFFAS 31, par. 10)

beneficiary, there is no account receivable. Instead, the entity would become responsible for disclosing cash only after a deposit is made.

18. Q 5: Is there any requirement to report fiduciary assets, liabilities or flows when the Federal entity does not perform any of the fiduciary activities listed in the definition, but does provide other services, such as advisory services that may lead to a contract being executed outside of the Federal government, with no further Federal role?

19. No. Certain activities that support beneficiaries may not lead to the creation of fiduciary or trust assets.

20. Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold.

21. For an activity to meet the definition of a fiduciary activity, the Federal entity has to:

    a. collect and receive fiduciary cash or other assets and

    b. subsequently perform one or more of the other activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

22. Q 6: In some cases, courts may direct third parties to make payments to an escrow account in a commercial bank to be distributed to harmed parties. The escrow accounts are not the property of the Federal government, and the interest income is subject to taxes. In some of these cases, a Federal agency may have some control over disbursements (e.g., by approving or disapproving a third-party distribution plan). Does this situation meet the definition of fiduciary activity in SFFAS 31?

23. No. In this example, the Federal agency has not received or collected the cash or other assets.

24. The definition of fiduciary activities is stated in SFFAS 31, par. 10:

    In a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold. Non-Federal parties must have an ownership interest in cash or other assets held by the Federal entity under provision of law, regulation, or other fiduciary arrangement. The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation.

25. Q 7: Does SFFAS 31 require reporting the monetary value of fiduciary land held in trust?

26. The reporting requirements for non-valued fiduciary assets are found in paragraph 18(d) of SFFAS 31: (bold added)

> *SFFAS 31*
>
> [18(d)] Component entities also may have non-valued fiduciary assets. Non-valued fiduciary assets are fiduciary assets for which required disclosure does not include dollar values. **Non-valued fiduciary assets may include land held in trust.** Component entities holding non-valued fiduciary assets should disclose them in a Schedule of Changes in Non-Valued Fiduciary Assets, which should include a description of non-valued fiduciary assets, beginning quantity, quantity received, quantity disposed of, net increase/decrease in non-valued fiduciary assets, and ending total quantity.

27. Under federal accounting standards, the vast majority of land will be classified as a non-valued asset.

28. Q: 8: How should the concept of materiality be applied to disclosures about fiduciary activities?

29. The Board's position on materiality is published in the Foreword to Original Pronouncements, Volume 1, available on the FASAB website at: https://fasab.gov/accounting-standards/document-by-chapter/

> *[Foreword, FASAB Original Pronouncements]*
>
> **Materiality**
>
> The Board intends that all standards' application be limited to items that are material. "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. Presented below is the Board's position on the issue of materiality at this time.
>
> The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

30. Additional guidance on materiality is provided in SFFAC 2, SFFAS 1, SFFAS 3, and the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct.

SFFAC 2

[78] Some of a reporting entity's components are likely to be required by law or policy to prepare and issue financial statements in accordance with accounting standards other than those recommended by FASAB and issued by OMB and GAO[3], e.g., accounting standards issued by the Financial Accounting Standards Board or accounting standards established by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB-issued standards that would not be required by the other standards.

[3] Note: After October 1999, FASAB issues standards absent an objection from the Office of Management and Budget (OMB) or the Government Accountability Office (GAO).

SFFAS 1

[12] Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

[13] 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.

SFFAS 3

[8] The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

[9] FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this 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. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered material if it would influence or change the judgment of the financial statement user.

31. In addition, the AICPA Code of Professional Conduct, Rule 203 states **(bold added)**:

AICPA Rule 203

Accounting Principles

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles **that has a material effect on the statements or data taken as a whole.** If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Materiality with respect to fiduciary disclosures should be based on professional judgment considering relevant qualitative and quantitative factors. Examples of quantitative factors include but are not limited to the relationship of fiduciary amounts to other appropriate information in the entity's principal financial statements including disclosures. For example, the quantitative materiality determination for each fiduciary item could be made based on the significance of those amounts to amounts recognized on the principal financial statements of the reporting entity, and/or on the significance of an individual item within the fiduciary amounts to all fiduciary amounts presented by the reporting entity.

In all cases, qualitative materiality aspects should be appropriately considered.

32. Q 9: May estimating techniques be used when reporting fiduciary disclosures?

33. Yes, estimating techniques may be used when reporting fiduciary disclosures. For example, accrual estimates may be developed and reported on a summary level.

34. When estimates are used for summary information for fiduciary activities, the fiduciary note may include disclosure of the use of estimates and explain that the actual results may vary from the estimates reported.

Effective Date

35. This guidance is effective upon issuance.

The provisions of this Staff Implementation Guidance need not be applied to immaterial items.

Basis for Conclusions

A1. After the issuance of SFFAS 31, several federal agencies had questions about its implementation. Staff drafted an initial draft SIG based upon questions from agencies and hosted a public meeting to discuss the draft.

A2. Revised draft SIG was posted for public comment for the required two-week comment period. Seven comment letters were received. Six comment letters were from federal preparers and one was from a non-federal professional organization. Based upon comments received, staff drafted revised SIG and forwarded it to the Board on March 3, 2009 for a 15-day review period. The final SIG was issued on March 19, 2009.

Staff Implementation Guidance 6.1: *Clarification of Paragraphs 40-41 of SFFAS 6, Accounting for Property, Plant, and Equipment,* as amended

Status

Issued	July 17, 2018
Effective Date	Effective upon issuance.
Affects	SFFAS 6, par. 40-41
Affected by	None.

Summary

This guidance addresses implementation guidance provided in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment,* as amended. Specifically, it responds to a question raised since the issuance of SFFAS 50*, Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*.

Table of Contents

Introduction

1. After the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, Federal Accounting Standards Advisory Board (FASAB or "the Board") staff identified certain necessary clarifications[1] regarding whether both of the alternative methods for establishing opening balances and the alternative for estimated net remaining cost per the second sentence in paragraph 41 of SFFAS 6, as amended, could be applied.

2. The below Staff Implementation Guidance (SIG) Q&A addresses the question raised by the Department of Defense (DoD). SIG does not establish new requirements. Rather, SIG is intended to assist preparers in the application of FASAB literature.

Technical Guidance

3. **Q1: Can both of the alternative methods for establishing opening balances provided by paragraph 40 of SFFAS 6, as amended, and the alternative to record property, plant, and equipment (PP&E) at its estimated net remaining cost provided by paragraph 41 of SFFAS 6, as amended, be applied?**

4. Yes. Paragraph 40 of SFFAS 6, as amended, provides alternative methods for establishing opening balances for reporting entities that meet the specified conditions and elect to apply any of the alternative methods available.

5. For those reporting entities, the implementation guidance provided in paragraph 41 of SFFAS 6, as amended, may also be applied. Paragraph 41 states:

> Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost[45] and depreciation/amortization charged over the remaining life based on that net remaining cost.
>
> [45]*Net remaining cost* is the original cost of the asset less any accumulated depreciation/amortization to date.

[1]These clarifications were outside the scope of the implementation guidance that FASAB provided in Technical Release (TR) 18, *Implementation Guidance for Establishing Opening Balances*.

6. This alternative allows for PP&E to be recorded at its estimated net remaining cost (often called net book value), which is the original cost of the asset less any accumulated depreciation/amortization to date.[2] This alternative was provided as a cost-beneficial option for the year of implementation.

7. An important premise for all the opening balance alternatives is that management should expect to provide adequate documentation that is consistent with the method used and supports the overall reasonableness of the valuation.[3] Further, management is also responsible for maintaining adequate documentation of data sources and the application of methodologies.[4] Applying the provisions of paragraph 41 does not alter the requirement to ensure adequate support for any values established for opening balances using the alternatives methods (such as deemed cost), including accumulated depreciation and in-service dates.

Effective Date

8. This guidance is effective upon issuance.

The provisions of this Staff Implementation Guidance need not be applied to immaterial items.

[2]Therefore, in the year of implementation the opening balance of accumulated depreciation would be zero and the depreciation/amortization expense would be charged based on the net remaining cost and the remaining life. This alternative also is applicable to required disclosures articulated in par. 45 of SFFAS 6, as amended.

[3]TR 18, par. 10.

[4]TR 18, par. 11.

Basis for Conclusions

FASAB has authorized its staff to prepare SIG to provide timely guidance on certain financial accounting and reporting problems, in accordance with the Board's rules of procedure, as amended and restated through October 2010. The provisions of SIG need not be applied to immaterial items.

This appendix discusses some factors considered significant by staff in reaching the conclusions in this SIG. 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.

This guidance may be affected by later Statements or other pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this SIG. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

A1. After the issuance of SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, DoD inquired whether the alternative methods for establishing opening balances could be applied in concert with the second sentence in paragraph 41 of SFFAS 6, as amended. Because "deemed cost" (as defined in the amendments to SFFAS 6) was not incorporated in paragraph 41, it may be unclear whether recording PP&E at "net remaining cost" is appropriate when deemed cost is used to establish initial amounts.

A2. FASAB staff drafted a response based upon the question received from DoD. Because deemed cost is a surrogate for initial costs, staff concluded the alternative to record PP&E at estimated net remaining cost is appropriate even when the surrogate or deemed cost is used. Staff hosted a public meeting with the preparer and auditor community to discuss the draft response.

A3. The participants discussed several issues regarding documentation and support for opening balances, including the underlying in-service dates, useful lives, and capital improvements. The participants noted concerns with these areas but understood that those particular issues went beyond the scope of the proposed SIG. Participants acknowledged that the proposed guidance related to a very narrow scope.

A4. The scope of this guidance is strictly to answer the question put forth in paragraph 3; it does not provide guidance on useful lives, estimating remaining useful lives, or the treatment of capital improvements.

A5. The proposed SIG 6.1: Clarification of Paragraphs 40-41 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, as amended, was available for public comment for the required 15-day period. FASAB staff received four comment letters from federal preparers. No disagreements or suggestions were provided.

A6. The Board has reviewed this SIG and a majority of members do not object to its issuance.

Appendix A: Topical Index

This index provides references to the topics in this Volume. References to the pronouncements are organized as follows: The first character indicates that it is a Concepts Statement (C), a Standards Statement (S), an Interpretation (I), a Technical Release (T), a Technical Bulletin (B) or Staff Implementation Guidance (G). This letter is followed by a number to indicate which pronouncement it refers to. The number is followed by a “P” for paragraph which is followed by the paragraph number(s). This index does not encompass all topics addressed in FASAB pronouncements, may not include all references for each topic, and should not be considered authoritative.

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.

A

TOPIC	REFERENCE

Appendix B: Effective Dates of Statements, Interpretations, and Technical Releases

Statement of Federal Financial Accounting Concepts (SFFAC)		
SFFAC 1	Objectives of Federal Financial Reporting	
SFFAC 2	Entity and Display	
SFFAC 3	Management's Discussion and Analysis	
SFFAC 4	Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government	
SFFAC 5	Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements	
SFFAC 6	Distinguishing Basic Information, RSI, and OAI	
SFFAC 7	Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording	
SFFAC 8	Federal Financial Reporting	
SFFAC 9	Materiality: Amending Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting, And SFFAC 3, Management's Discussion and Analysis	

Statement of Federal Financial Accounting Standards (SFFAS)		**Effective for Fiscal Periods Beginning After**
SFFAS 1	Accounting for Assets and Liabilities	9/30/93
SFFAS 2	Accounting for Direct Loans and Loan Guarantees	9/30/93
SFFAS 3	Accounting for Inventory and Related Property	9/30/93
SFFAS 4	Managerial Cost Accounting Standards	9/30/97
SFFAS 5	Accounting for Liabilities of the Federal Government	9/30/96
SFFAS 6	Accounting for Property, Plant, and Equipment	9/30/97
SFFAS 7	Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting	9/30/97
SFFAS 8	Supplementary Stewardship Reporting (**RESCINDED 9/30/2019)**	9/30/97
SFFAS 9	Deferral of Implementation Date for SFFAS 4	9/30/97
SFFAS 10	Accounting for Internal Use Software	9/30/00
SFFAS 11	Amendments to Accounting for PP&E—Definitions—**(RESCINDED 9/30/2002)**	9/30/98
SFFAS 12	Recognition of Contingent Liabilities from Litigation	9/30/97

		Effective for Fiscal Periods Beginning After
SFFAS 13	Deferral of Paragraph 65.2—Material Revenue-Related Transactions Disclosures	9/30/98
SFFAS 14	Amendments to Deferred Maintenance Reporting (**RESCINDED 9/30/2014)**	9/30/98
SFFAS 15	Management's Discussion and Analysis	9/30/99
SFFAS 16	Amendments to Accounting for Property, Plant, and Equipment—Multi-Use Heritage Assets **(RESCINDED 9/30/2005)**	9/30/99
SFFAS 17	Accounting for Social Insurance	9/30/99
SFFAS 18	Amendments To Accounting Standards For Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2	9/30/00
SFFAS 19	Technical Amendments to Accounting Standards for Direct and Guaranteed Loans	9/30/02
SFFAS 20	Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs and Others	9/30/00
SFFAS 21	Reporting Corrections of Errors and Changes in Accounting Principles	9/30/01
SFFAS 22	Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations **(RESCINDED 9/30/2018)**	9/30/00
SFFAS 23	Eliminating the Category National Defense PP&E	9/30/02
SFFAS 24	Selected Standards for the Consolidated Financial Report of the United States Government	9/30/01
SFFAS 25	Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment	9/30/02
SFFAS 26	Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25	9/30/2005
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 **(RESCINDED 9/30/2018)**	9/30/2005
SFFAS 31	Accounting for Fiduciary Activities	9/30/2008
SFFAS 32	Consolidated Financial Report of the United States Government Requirements	9/30/2005
SFFAS 33	Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates	9/30/2009
SFFAS 34	The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board	Upon issuance

		Effective for Fiscal Periods Beginning After
SFFAS 35	Estimating the Historical Cost of General Property, Plant, and Equipment -- Amending Statements of Federal Financial Accounting Standards 6 and 23 **(RESCINDED 9/30/2016)**	Upon issuance
SFFAS 36	Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government	9/30/2009
SFFAS 37	Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements	9/30/2010
SFFAS 38	Accounting for Federal Oil and Gas Resources	9/30/2011
SFFAS 39	Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the Statements of Auditing Standards	Upon issuance
SFFAS 40	Definitional Changes Related to Deferred Maintenance and Repairs: Amending SFFAS 6, Accounting for PP&E	9/30/2011
SFFAS 41	Deferral of the Effective Date of SFFAS 38, Accounting for Federal Oil and Gas Resources	Upon Issuance
SFFAS 42	Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32	9/30/2014
SFFAS 43	Dedicated Collections: Amending SFFAS 27, Identifying and Reporting Earmarked Funds	9/30/2012
SFFAS 44	Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use	9/30/2014
SFFAS 45	Deferral of the Transition to Basic Information for Long-Term Projections **(RESCINDED 10/17/2014)**	Upon issuance
SFFAS 46	Deferral of the Transition to Basic Information for Long-Term Projections	Upon issuance
SFFAS 47	Reporting Entity	9/30/17
SFFAS 48	Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials	9/30/16
SFFAS 49	Public-Private Partnerships: Disclosures Requirements	9/30/18
SFFAS 50	Opening Balances for General PP&E	9/30/16
SFFAS 51	Insurance Programs	9/30/18
SFFAS 52	Tax Expenditures	9/30/17
SFFAS 53	Budget and Accrual Reconciliation	9/30/18
SFFAS 54	Leases; An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment	9/30/2023
SFFAS 55	Amending Inter-Entity Cost Provisions	9/30/2018
SFFAS 56	Classified Activities	9/30/2018
SFFAS 57	Omnibus Amendments 2019	Multiple; see SFFAS 57
SFFAS 58	Deferral of the Effective Date of SFFAS 54, Leases	Upon issuance

		Effective for Fiscal Periods Beginning After
SFFAS 59	Accounting and Reporting of Government Land	The scope of this Statement (paragraphs 1-3) is effective for reporting periods beginning after September 30, 2021.
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 **(RESCINDED 9/30/2009)**	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 **(RESCINDED 9/30/2018)**	6/00
I-7	Items Held for Remanufacture	3/16/2007
I-8	Classified Activities	3/15/2019
I-9	Cleanup Cost Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5 & SFFAS 6	8/16/2019
I-10	Clarification of Non-federal Non-entity FBWT Classification (SFFAS 1, Paragraph 31): An Interpretation of SFFAS 1 and SFFAS 31	5/10/2021
Technical Bulletins		**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
2006-1	Recognition and Measurement of Asbestos-Related Cleanup Costs	9/28/2006
2009-1	Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Costs	9/22/2009
2011-1	Accounting for Federal Natural Resources Other Than Oil and Gas	9/30/2013
2011-2	Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Costs	11/22/2011
2017-1	Intragovernmental Exchange Transactions	11/1/2017
2017-2	Assigning Assets to Component Reporting Entities	11/1/2017
2020-1	Loss Allowance for Intragovernmental Receivables	2/20/2020

Technical Releases		Date Issued
TR-1	Audit Legal Letter Guidance	3/1/98
TR-2	Environmental Liabilities Guidance	3/15/98
TR-3	Preparing and Auditing Estimates for Direct and Guaranteed LoansTR-3: **(RESCINDED 1/22/2004)**	2/99
TR-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*	1/04
TR-4	Reporting on Non-valued Seized and Forfeited Property	7/31/99
TR-5	Implementation Guidance on SFFAS 10: Accounting for Internal Use Software – Rescinded **(RESCINDED 1/19/2016)**	5/14/02
TR-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*	1/04
TR-7	Clarification of Standards Relating to the National Aeronautics and Space Administration's Space Exploration Equipment	5/25/2007
TR-8	Clarification of Standards Relating to Inter Entity Costs (**RESCINDED 1/15/2019)**	2/20/2008
TR-9	Implementation Guide for SFFAS29: Heritage Assets and Stewardship Land	2/20/2008
TR-10	Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment	6/2/2010
TR-11	Implementation Guidance on Cleanup Costs Associated with Equipment	6/2/2010
TR-12	Accrual Estimates for Grant Programs	8/4/2010
TR-13	Implementation Guide for Estimating the Historical Cost of General PP&E	6/1/2011
TR-14	Implementation Guidance on the Accounting for the Disposal of General Property, Plant & Equipment	10/6/2011
TR-15	Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation	9/26/2013
TR-16	Implementation Guidance for Internal Use Software	1/19/2016
TR-17	Conforming Amendments to Technical Releases	4/10/2017
TR-18	Implementation Guidance for Establishing Opening Balances	10/2/2017
TR-19	Rescission of Technical Release 8	1/15/2019
Staff Implementation Guidance		**Date issued**
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

Staff Implementation Guidance		Date issued
SIG 31.1	Guidance for Implementation of SFFAC 31, Accounting for Fiduciary Activities	3/19/2009
SIG 6.1	Clarification of Paragraphs 40-41 of SFFAS 6, Accounting for Property, Plant, and Equipment, as amended	7/17/2018

Appendix C: Memorandum of Understanding Among The Government Accountability 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 nine members:

- one GAO member,
- one OMB member,
- one Treasury member, 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, and Treasury 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;

(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

(3) consider the recommendations of a panel convened by the chairperson.

The Sponsors will select a chairperson, who will be a non-federal member.

C. Tenure. The GAO, OMB, and Treasury 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.

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.

Section 3. Accounting Concept and Standard-Setting Process. The Board will follow a six-step process for considering accounting concepts and standards. The steps in the process are:

(1) Identification of accounting issues and agenda decisions,

(2) Preliminary deliberations,

(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) At least a two-thirds majority vote reached among Board members in favor of proposed concepts and standards submitted to the Comptroller General, the Secretary of the Treasury, and the Director of OMB.

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, and the Secretary of the Treasury for their review. If, within 90 days after its submission, the Comptroller General or the Director of OMB, (or both) objects (object) to the concept or standard, then it shall not be issued and will be returned to the Board for further consideration; provided however, that the Comptroller General or the Director of OMB, may, in the event that unanticipated circumstances make it difficult for the Comptroller General or the Director of OMB to complete the 90 day review timely, extend the review time for one additional 90 day period. If the Comptroller General or the Director of OMB implements such an extension, he or she will notify the FASAB Chair. If neither the Comptroller General nor the Director of OMB objects to the concept or standard during the review time provided in this paragraph, including any extension of the review time, 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. 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 6. Effective Date. This memorandum of understanding is effective when executed by the Sponsors.

___/s/___________________________ _____________

Timothy F. Geithner 12/3/2009
Secretary of the Treasury

___/s/___________________________ _____________

Peter R. Orszag 11/2/2009
Director, Office of Management
and Budget

____/s/__________________________ _____________

Gene L. Dodaro 10/5/2009
Acting Comptroller General of the
United States

Appendix D: Other Federal Accounting and Auditing Resources

For other helpful resources, see http://www.fasab.gov/resources/.

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)

Acres of Land Held for Disposal or Exchange

Land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question. Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

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 Gains and Losses

A change in the value of an estimated liability (or the benefit plan's assets) resulting from experience different from that assumed or from a change in an actuarial assumption. Past experience is reflected in current costs through actuarial gains and losses.

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.

Adverse Event

May be a single-occurring event or a series of events that cause losses to the beneficiary or beneficiaries as identified in the insurance arrangement.

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, *Project on Standardization of Basic Financial Information Requirements of Central Agencies*, 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, *Instructions on Budget Execution*, 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.

Annual Cost Increment

The annual cost increment component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. See **Normal Cost** below for pensions, ORB, and OPEB.

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 “*forecast*” and “*projection*.”)

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 *Circular A-34*)

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.

Arrangement Period

Is the period over which adverse events that occur are covered.

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

A resource that embodies economic benefits or services that the federal government controls.

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.

Baseline provisions

Baseline provisions are the starting points used to measure the impact of tax expenditures on tax revenues as compared to revenues that would be collected otherwise, absent the special exclusion, exemption, deduction, credit, preferential rate, or deferral. Certain practical aspects of the code are incorporated into the baseline-such as progressive tax rates, personal exemptions, standard deductions, deductions of expenses incurred in order to earn income, and deferrals of unrealized income.

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)

Basic Information

Information that is essential for financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).

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.

Beneficiary

An individual or other entity legally entitled to enforce an obligation against the United States such as specified benefits from a fiduciary trust or agent.

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.

Black Lung Benefits Program

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.

- 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 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:

- 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, *Objectives of Federal Financial Reporting*, 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. (GAO *Budget Glossary*)

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. [*This definition will be rescinded when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

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, *Objectives of Financial Reporting by Nonbusiness Organizations*, paragraph 50; and Congressional Budget Office, *Glossary of Budgetary and Economic Terms*, “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.

Cash Surrender Value

Is the sum of money an insurance company will return to the policyholder if the policy is canceled before its maturity or the insured event (death) occurs.

Category I nonfriable asbestos-containing material (ACM)

Refers to asbestos-containing packings, gaskets, resilient floor covering, and asphalt roofing products containing more than 1 percent asbestos as determined using the method specified in appendix E, subpart E, 40 CFR part 763, section 1, Polarized Light Microscopy. (40 CFR § 61.141)

Category II nonfriable ACM

Refers to any material, excluding Category I nonfriable ACM, containing more than 1 percent asbestos as determined using the methods specified in appendix E, subpart E, 40 CFR part 763, section 1, Polarized Light Microscopy that, when dry, cannot be crumbled, pulverized, or reduced to powder by hand pressure. (40 CFR § 61.141)

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)

Claim Adjustment Expenses (CAE)

Are incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

Classified National Security Information

also known as "classified information," is any information that has been determined pursuant to Executive Order (E.O.) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

> **TOP SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;
>
> **SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and
>
> **CONFIDENTIAL,** which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

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 "*Closed group (to new entrants)*."

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 *Circular A-11*)

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 *A Glossary Of Terms Used in the Federal Budget Process; and Related Accounting, Economic, and Tax Terms*, Third Edition, General Accounting Office, March 1981.)

Commercial Use Land

Land or permanent land rights that are predominantly used to generate inflows of resources from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. [See SFFAS 6 paragraph 20B. for example commercial use land sources from which revenue or inflows are derived.]

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, *Entity and Display*, 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.

Component Reporting Entity

“Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.[1] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

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.

[1]The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

Conservation and Preservation land

Land or permanent land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. [See SFFAS 6 paragraph 20C. for examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources.]

Conservatorship

A conservatorship is the legal process in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the company's directors, officers, and shareholders are transferred to the designated conservator.[2]

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 *Budget Glossary*)

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

[2] Federal Housing Finance Agency Fact Sheet, Questions and Answers on Conservatorship

that the agent maintains physical possession and control of the property on behalf of, and subject to the orders of, the Federal government personnel.

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 *budget authority*.)

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.

Control with risk of loss or expectation of benefit

Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or obtain financial resources or non-financial benefits.[3]

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, *Objectives of Federal Financial Reporting* as the monetary value of resources used (para. 195). Defined more specifically in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, 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 *Accounting for Revenue and Other Financing Sources*, “cost” is used synonymously with expense. See also “*Full Cost*.”

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.

[3] For example, a non-financial benefit would be one where the federal government benefits from a service being provided to it or on its behalf.

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. [*Special Term from SFFAS 2*]

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.

Current Policy Without Change

In federal financial reporting, "current policy without change" refers to the continuation of policies in place as of the valuation date (in other words, no policy change).

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.

Debt-to-GDP Ratio

The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by gross domestic product. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]

Dedicated Collections

Dedicated collections are specifically identified revenues, provided to the government by non-federal sources, 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 funds from dedicated collections are:

1. A statute committing the federal government to use specifically identified revenues and or other financing sources that are originally provided to the federal government by a non-federal source* only for designated activities, benefits or purposes;

2. Explicit authority for the 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 fund from the government's general revenues.

*In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

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. (*Treasury Financial Manual Supplement*)

Deemed Cost

Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

Deferred Maintenance and Repairs

Maintenance and repairs that were not performed when they should have been or were scheduled to be and which, therefore, are put off or delayed for a future period.

Demographic Assumptions

Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Deposit Fund

Treasury Financial Management Service establishes deposit fund accounts to record monies that do not belong to the Federal government. A description of deposit fund criteria may be found in the Treasury Financial Manual, Section 1535, "Deposit Fund Accounts."

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.

Derivative Classification

Is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

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 *Circular A-11*)

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.

Discretionary Spending

In the federal budget process, "discretionary spending" refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not "mandatory." For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

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 Fund

This term was used in SFFAS 27 and rescinded by SFFAS 43; see “Dedicated Collections.”

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 Assumptions

Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

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, *Elements of Financial Statements*)

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.

Exchange Transaction Insurance Programs Other Than Life Insurance

Cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined in SFFAS 7.

Executory Contract

A contract which has not been performed by all parties to it. (Trascona, Joseph L., *Business Law*, 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, *Accounting for Leases*)

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. (GAO *Budget Glossary*)

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)

Fair Value

Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federally Funded Research and Development Center

Federally Funded Research and Development Center (FFRDC) is a government-funded entity that has a long-term contractual relationship with one or more federal agencies.[4] FFRDCs can be privately owned or government-owned, and they serve to meet the long-term research and development needs of federal agencies that could not otherwise be met as effectively in-house or through existing contractors. 49 Fed. Reg. at 14,464; 48 C.F.R. § 35.017(a). FFRDCs are established either specifically in statute or under the statutory authority of agencies to enter into contracts, which can be inherent or specific authority, and are used to perform research and development and related tasks.

Fiduciary

(noun) A Federal entity that holds assets in trust for non-Federal parties in which the non-Federal parties have an ownership interest that the Federal Government must uphold.

(adjective) Relating to the process of the collection or receipt, and the 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.

[4] The Office of Federal Procurement Policy (OFPP) and Federal Acquisition Regulation (FAR) policies for FFRDCs apply to executive agencies, which includes “an executive department, a military department, or any independent establishment within the meaning of 5 U.S.C. 101, 102, and 104(1), respectively, and any wholly owned Government corporation within the meaning of 31 U.S.C. § 9101.” 48 C.F.R. § 2.101; see also 5 U.S.C. § 403.

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 Asset

Fiduciary assets are assets in which non-Federal parties have an ownership interest and are held by a Federal entity under provision of law, regulation or other fiduciary arrangement.

Fiduciary Collections

Fiduciary collections are an inflow to a Federal entity of cash or other assets in which non-Federal parties have an ownership interest that the Federal Government must uphold.

Fiduciary Fund Balance with Treasury

Cash that is held in the U.S. Treasury and administered by a Federal entity on behalf of fiduciary beneficiaries.

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 *Circular A-11*, and OMB *Circular A-34*, Instructions on *Budget Execution*, Credit Apportionment and Budget Execution, hereafter cited as OMB *Circular A-34*.)

First-in, First-out (FIFO)

A cost flow assumption; the first goods purchased or produced are assumed to be the first goods sold.

Fiscal Gap

The fiscal gap is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of GDP. The fiscal gap is the net present value of projected non-interest spending[5] minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at the target level for the stated projection period. The fiscal gap may be expressed as:

(a) a summary amount in present value dollars,

(b) a share of the present value of the GDP[6] for the projection period, and/or

(c) a share of the present value of projected receipts or projected non-interest spending.

Fiscal Sustainability Reporting

In federal financial reporting, "Fiscal Sustainability Reporting" is the short term for the basic financial statement, disclosures and Required Supplementary Information required in the Financial Report of the U.S. Government.

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.

[5]Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest.

[6]GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

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. (*Treasury Financial Manual Supplement*)

Forfeited Property

Forfeited property is property for which title has passed to the Government. Forfeited property includes (1) monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.

Friable ACM

Refers to material containing more than 1 percent asbestos as determined using the method specified in appendix E, subpart E, 40 CFR part 763, section 1, Polarized Light Microscopy, that, when dry, can be crumbled, pulverized, or reduced to powder by hand pressure. If the asbestos content is less than 10 percent as determined by a method other than point counting by polarized light microscopy (PLM), the asbestos content is verified by point counting using PLM. (40 CFR § 61.141)

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, *Managerial Cost Accounting Concepts and Standards for 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*).

Fulfillment Cost

Fulfillment cost includes all costs that an entity will incur in fulfilling the promises that constitute a liability.

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.[7] 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.

A fund can also mean a fiscal and accounting entity with a self-balancing set of accounts recording cash and other assets, together with all related liabilities and residual equities or

[7] An explanation of the two major categories of Federal Funds and Trust Funds may be found in Chapter 22, "Trust Funds and Federal Funds," of Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2006.

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.

The term "fund" is used in multiple contexts in this standard. For example, the introductory and background material discusses funds in the context of budget accounting. On the other hand, when the standard refers to a fiduciary fund in the illustrations that follow this Glossary, it is in the context a self-balancing set of accounts.

Fully Insured

"Fully insured" status means that a social insurance participant is eligible for benefits. Social insurance benefits include pensions and health care for retirees and the disabled. For example, Social Security and Medicare participants become permanently fully insured when they attain at least 40 quarters of work in covered employment (QC). Social Security and Medicare participants may be fully insured without being permanently fully insured. This is important with respect to disability benefits, which include subsistence payments and medical care. Disability benefits may be needed well before the participants attained retirement age. A participant who receives disability benefits for 24 consecutive months is eligible for Medicare and, if he or she continues receiving disability benefits until attaining retirement age, he or she is converted to Social Security retirement benefits. To be fully insured, participants generally need a minimum of 6 QC. Once a worker has accumulated 40 QCs, he or she remains permanently fully insured, that is, no further QCs are required.

Fund Balance with Treasury

A Federal entity's fund balance with the Treasury 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. Fund balance with Treasury is an intra-governmental item. From the component entity's perspective, a fund balance with Treasury is an asset because it represents the entity's claim to the Federal Government’s resources. However, from the perspective of the Federal Government as a whole, it is not an asset; and while it represents a commitment to make resources available to Federal departments, agencies, programs and other entities, it is not a liability. An entity's fund balance with Treasury is increased by, among other things, amounts collected and credited to a fund that the entity is authorized to spend or use to offset its expenditures. Disbursements made to pay liabilities or to purchase assets, goods, and services, investments in Treasury or other securities, transfers and reimbursements to other entities or to the Treasury, and similar transactions reduce an entity's fund balance with Treasury.

Garnishments

Garnishments are a method of debt collection in which a portion of a person's salary or tax refund is paid to a third party in compliance with a statute or court order.

Non-Federal Parties - See "Non-Federal Individuals and Entities."

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 permanent land rights acquired for or in connection with other general PP&E are considered general PP&E but are not to be capitalized on the balance sheet. General PP&E land shall exclude (1) withdrawn public lands or (2) land restricted for conservation, preservation, historical, or other like restrictions.

General Purpose Federal Financial Reports

General purpose federal financial reports (GPFFRs) is a generic term to refer to the report that contains the reporting entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government-wide reporting entity is known as the consolidated financial report of the U.S. Government (CFR) and for component reporting entities it is usually included in the performance and accountability report, the agency financial report, or the annual management report.

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.

Government Sponsored Enterprise

Government Sponsored Enterprise (GSE) is created by Congress with its particular attributes defined in its enabling legislation and charter. Despite this diversity, there are at least four readily observable characteristics of GSEs: (1) private sector ownership, (2) limited competition, (3) activities limited by congressional charter, and (4) chartered privileges that create an inferred federal guarantee of obligations.[8]

[8] Congressional Research Service Report for Congress *Government-Sponsored Enterprises (GSEs): An Institutional Overview*

Grants

31 USC Sec. 6304 defines grants as follows: An executive agency shall use a grant agreement as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when (1) the principal purpose of the relationship is to transfer a thing of value to the State or local government or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and (2) substantial involvement is not expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.

Gross Domestic Product

A nation's gross domestic product is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are:

GDP = private sector consumption and investment + government consumption and investment + net exports (exports - imports).

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.

Held for Remanufacture

Items in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of direct materials, (including repairable parts and subassemblies, also referred to as "carcasses" at the Department of Defense) and work-in-process (including labor costs).

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.

Impairments

A significant[9] and permanent decline in the service utility of G-PP&E or expected service utility for construction work in progress.

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.

[9]The determination of whether or not an item is significant is a matter of professional judgment. Determining if a decline in service utility is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

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.

Incurred But Not Reported (IBNR)

Refers to estimated claims from adverse events that have occurred as of the end of the reporting period, but have not yet been reported to the insurance program for settlement.

Indirect Cost

A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.

In-Force

Refers to arrangements that are unexpired as of a given date.

Initial Direct Lease Cost

Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Insurance Arrangement (Arrangement)

Is a general term used for a contract or other agreement between an insurance program and specific parties, such as but not limited to individuals, state, local, or foreign governments, other federal agencies, or businesses. An arrangement may include and/or identify: the term the insurance arrangement is in-force, the insurance program’s responsibilities, the risk assumed by the insurance program, such as: all risk for covered losses, partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance, a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid or risks shared by a third party; the adverse event, the insured party or parties and their premium requirements, the beneficiary or beneficiaries and their responsibilities for filing claims, and/or the financial compensation.

Insurance Claim

Is a formal request for payment for losses as authorized under the insurance arrangement.

Insurance Portfolios

Is a grouping of insurance programs or arrangements that have some meaningful relationship based on arrangement period/duration, shared risks, management, customers, geographic regions, or other factors.

Insurance Program

Is a general term used to refer to a program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

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 *separate definition of social insurance*).

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.

Intergenerational Equity

Intergenerational equity refers to the extent that different age groups are required to assume the financial burdens for services provided to other age groups.

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.

Intragovernmental Lease

An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*[1] whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted*.]

Inventory

Inventory is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

[1] SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (SFFAS 47 par. 38–42).

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.

Land Acquired for or in Connection with Other General PP&E

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.

Land Held for Disposal Acres of or Exchange

Land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question. Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

Last-in, First-out (LIFO)

A cost flow assumption; the last goods purchased are assumed to be the first goods sold.

Land Rights

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. Land rights such as easements or rights-of-way that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

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.

Lease

A lease is a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E) (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

Legacy Entity

An entity from which a smaller entity or specific function is being transferred. (Technical Bulletin 2003-1)

Lessee's Estimated Incremental Borrowing Rate

The lessee's estimated incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.*]

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee. [*This definition will become effective when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.]*

Level of Utilization

The portion of the usable capacity currently being used.

Liability

For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.

Liability for Losses on Remaining Coverage

Is an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open arrangement period.

Life-cycle Costing

An acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets.

Life Insurance Programs

Cover the risk of loss from death of individuals involved in exchange transactions as defined in SFFAS 7.

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 *Circular A-11*)

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.

Long-term Assumptions

Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events the entire series should be considered the event and, thus, the payment may commence within one year but would be required to extend at least five years. Otherwise, the asset or liability would be classified as short-term.

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.

Mandatory Spending

"Mandatory spending" includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation acts. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

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.

Measurement Approach

The measurement approach is how an asset or liability is measured in periods after initial recording-i.e., at the historical cost or initial transaction amount (with subsequent adjustments for amortization, depreciation, or depletion, if applicable) or at an amount, such as fair value, measured at each financial statement date.

Measurement Attribute

The measurement attribute (or measurement basis) is a measurable characteristic of an asset or liability, such as its fair value or settlement amount.

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 *Circular A-11*)

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.

Nonexchange Transaction Insurance Programs

Cover the risk of loss from adverse events through nonexchange transactions as defined in SFFAS 7.

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.

Nonfriable ACM

refers to any material containing more than 1 percent asbestos as determined using the method specified in appendix E, subpart E, 40 CFR part 763, section 1, Polarized Light Microscopy, that, when dry, cannot be crumbled, pulverized, or reduced to powder by hand pressure. (40 CFR § 61.141)

Nonrecognized events

Subsequent events that provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date.

Non-Valued Fiduciary Assets

Fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Fiduciary non-valued assets should be disclosed in accordance with generally accepted accounting principles.[10]

[10] In the future, the Board may require dollar values for certain categories. In the event of such a change in accounting principles, the affected categories would no longer be included in non-valued fiduciary assets.

Normal (or Service) Cost

The normal cost component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. For pensions, ORB, and OPEB, it represents that portion of the actuarial present value of benefits and expenses attributed to the valuation year by the benefit plan formula to work in covered employment or other service rendered by the participant in the period. The normal cost is a component of the annual expense and liability of the program and is not affected by the funded status of the plan.

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 *FY 2003 Budget of the United States Government: Analytical Perspectives*, "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, *The Budget System and Concepts*)

Offsetting Receipts

Offsetting receipts are a subset of offsetting collections. (See *collections*.)

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.

Opening Balances

Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[11]

[11] Adopted from AU-C 510, *Opening Balances - Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

Operational land

Land or land rights predominantly used for general or administrative purposes. [See SFFAS 6 paragraph 20D. for the operational land sub-category functions].

Operating Lease

An agreement conveying the right to use property for a limited time in exchange for periodic rental payments. [*This definition will be rescinded when SFFAS 54, Leases, becomes effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted*.]

Operating Materials and Supplies

Operating Materials and Supplies consist of tangible personal property to be consumed in normal operations. Excluded are: (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

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 Classification Authority

Is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.

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 Accompanying Information

Information that accompanies basic information and required supplementary information, but is not required by a body that establishes GAAP.

Other Financing Sources

Inflows of resources that increase net position of a reporting entity during the reporting period but that are not revenues or gains. They include appropriations used, transfers of assets from other Government entities, and financing imputed with respect to any cost subsidies. 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.

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.

Ownership Interest

The possession of substantially all of the benefits and risks incident to ownership.

Partial impairment

less than full or total impairment.

Payroll withholdings

Amounts that are withheld from payment of wages to an employee and subsequently remitted to other payees, such as Federal, State or local governments; or health or life insurance providers, on behalf of the employee.

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.

Policy Assumptions

Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address projected spending rules for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.

Post-1991 Direct Loans

Direct loans obligated after September 30, 1991. [*Special Term from SFFAS 2*]

Post-1991 Loan Guarantees

Loan guarantees committed after September 30, 1991. [*Special Term from SFFAS 2*]

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). (*Special Term from SFFAS 19*)

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). (*Special Term from* SFFAS 19)

Predominant Use of Land

The major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

Premiums

Is a general term used to refer to exchange revenue billed by insurance programs. Programs may refer to their exchange revenue by various terms, including but not limited to premiums, assessments, and/or fees.

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). (*Special Term from* SFFAS 19)

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). (*Special Term from* SFFAS 19)

Pre-1992 Loan Guarantees

Loan guarantees committed before October 1, 1991. [*Special Term from SFFAS 2*]

Pre-1992 Direct Loans

Direct loans obligated before October 1, 1991. [*Special Term from SFFAS 2*]

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, *Intermediate Accounting*, 7th ed., page 264.)

Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the "time value of money" into consideration. The "time value of money" is illustrated by a question such as: "At ten percent interest (compounded annually), how much do I need to put into the bank today in order to have $110 one year from today?" The amount you would need today would be $100. Therefore, the present value of $110 in this example would be $100.

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, *Entity and Display*, paragraph 71, footnote 12.] (See also Basic Financial Statements)

Prior Service Costs

The cost of retroactive benefits granted in a plan amendment or accomplished through administrative change, legislation, or other means. In some cases there will not be a formal "plan" per se to amend, for example, certain postemployment benefits, and a program is amended through other means than a formal "amendment."

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 *Circular A-11*)

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 of 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.

As used in Statement of Federal Financial Accounting Standards 36, Long-Term Projections for the U.S. Government, a projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions-for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

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).

Public Domain Land

Land that was originally ceded to the United States by treaty, purchase, or conquest in contrast to acquired lands, which have been purchased by, given to, exchanged with, or transferred through condemnation proceedings to the federal government.

Public-Private Partnerships

Federal public-private partnerships (P3s) are risk-sharing arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

P3 Structural Arrangement

P3s that are external to the government sponsor's or entity's operations and often involve the creation of an SPV, Trust, or Limited Partnership (LP), and other such arrangements. For example, military base housing.

P3 Transactional Arrangement

P3s that are internal to the government sponsor's or entity's operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP, etc.

Public Services

In federal financial reporting, "public services" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, cash (such as Social Security benefits) or other financial benefits (such as loan guarantees), as well as national defense, national security, transportation safety and the operation of national parks.

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)

Reasonably Estimable

The ability to reliably quantify in monetary terms the outflow of resources that will be required. (TR 2)

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.

Receivership

Receivership is the legal procedure for winding down the affairs of an insolvent institution.[12]

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, *A Replacement of FASB Concepts Statement No. 3*, 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.

Recognized events

Subsequent events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI.

[12] *Managing the Crisis: The FDIC and RTC Experience,* Appendix B - List of Abbreviations and Glossary of Terms; available online at http://www.fdic.gov/bank/historical/managing/; last accessed October 11, 2012.

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.

Recoveries

Include monies: returned from another agency through an indemnification agreement, a third party or commercial insurance company to repay all or part of a loss originally paid for by the program, recouped from the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or received from adjustments to previously paid insurance claims.

Reestimate

Refers to estimates of the subsidy costs performed subsequent to their initial estimates made at the time of a loan’s disbursement.

Regulated ACM

Refers to (a) Friable ACM, (b) Category I nonfriable ACM that has become friable, (c) Category I nonfriable ACM that will be or has been subjected to sanding, grinding, cutting, or abrading, or (d) Category II nonfriable ACM that has a high probability of becoming or has become crumbled, pulverized, or reduced to powder by the forces expected to act on the material in the course of demolition or renovation operations regulated by this subpart. (40 CFR § 61.141)

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 *offsetting collections.*)

Related Parties

Organizations are considered to be related parties in the GPFFR if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions. Relationship, as used in this context, refers to material transactions or events involving both parties.

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.

Replacement Cost (SFFAC 7)

Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life.

Reporting Entity

Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term "reporting entity" may refer to either the government-wide reporting entity or a component reporting entity.

Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity. The criteria focus on whether:

a. An entity's management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that the entity is included in the budget), and is held accountable for the entity's performance.

b. An entity's financial statements would provide a meaningful representation of operations and financial condition.

c. An entity's financial information could be used by nterested parties to help them make resource allocation and other decisions and hold the entity accountable.

Required Information

Information that consists of basic and required supplementary information.

Required Supplementary Information

Information that a body that establishes GAAP requires to accompany basic information. When an auditor is engaged to audit an entity's financial statements, basic information is subject to testing for fair presentation in conformity with GAAP. However, RSI for federal entities is unaudited but subject to certain procedures specified by Generally Accepted Government Auditing Standards for RSI.

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

See "Exchange Revenue" and "Nonexchange Revenue."

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 *Circular A-34*)

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 *Circular A-11*)

Risk-free Interest Rate

The rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows. See Time Value of Money below.

Seized Property

Seized property includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.

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.

Service Utility

The usable capacity that at acquisition was expected to be used to provide service.

Settlement Amount

Settlement amount is the amount at which an asset can be realized or a liability can be liquidated.

Short Term Lease

A short-term lease is a lease with a lease term of 24 months or less.

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 *separate definition of insurance and guarantees*).

Special Fund

Federal fund accounts for receipts earmarked for specific purposes and the associated expenditure of those receipts. (OMB, *The Budget System and Concepts*)

Special Purpose Vehicles (SPVs)

also commonly called Special Purpose Entities (SPEs), are entities created for a specific, limited and normally temporary purpose. An SPV can be a corporation, trust, partnership, limited-liability company or some type of Variable Interest Entity (VIE). They are often an integral part of public private partnerships because of their risk-containment nature of isolating participating entities from financial risk.

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

Public domain and acquired land and land rights owned by the federal government intended to be held indefinitely. [See SFFAS 29 paragraph 33. for examples of stewardship land reserved, managed, planned, used, or acquired for.]

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.

Subsequent events

Events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.

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 *Circular A-11*) 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 *Circular A-11*) 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 Expenditures

The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344) defines tax expenditures as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”

While the term “revenue losses” is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

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.

Time Value of Money

The time value of money is represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows (risk-free interest rate). For present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate risk-free interest rate. U.S.

Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

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.

Total (full) impairment

G-PP&E is no longer capable of providing service in the operations of the entity prior to the end of its estimated useful life.

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, *Statement of Financial Accounting Concepts No. 6*, 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 *Budget Glossary*)

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*).

Unreserved Assertion

An unconditional statement.

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.

Valuation date

A date as close to the end of the fiscal year being reported upon as possible and no more than one year prior to the end of the reporting year.

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.

Value for Money (VFM)

VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be. In other words, VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability.

Value in Use

Value in use is the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life.

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

AALP	Asset Acquisition Lifecycle Phases
AAPC	Accounting and Auditing Policy Committee
ABA	American Bar Association
AGA	Association of Government Accountants
AEAN	aggregate entry age normal
AFDC	Aid to Families with Dependent Children
AICPA	American Institute of Certified Public Accountants
AMC	Acquisition Management Costs
ANPV	actuarial net present value
APB	Accounting Principles Board
APV	actuarial present value
ARB	Accounting Research Bulletin
ASB	Auditing Standards Board
ASC	Accounting Standards Codification
AU	Auditing Standards
AU-C	Auditing Standards - Clarified
AUP	Agreed Upon Procedures
BFC	Basis for conclusions
CAAS	Contractor Assistance and Advisory Service
CAI	Cost Accounting Issues
CAE	Claim adjustment expense
CARC	Chemical Agent Resistant Coating
CBO	Congressional Budget Office
CCC	Commodity Credit Corporation
CEFMS	Corps of Engineers Financial Management System
CERCLA	Comprehensive Environmental Response Compensation and Liability Act of 1980
CFC	Chlorofluorocarbon
CFO	Chief Financial Officers
CFOC	Chief Financial Officers' Council
CFO Act	Chief Financial Officers Act
CFR	Code of Federal Regulations
CFS	consolidated financial statements
CFR	Consolidated Financial Report of the U.S. Government
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CIP	Construction in process
COEMIS	Corps of Engineers Management Information System
COLA	cost of living adjustment
COTS	Commercial Off The Shelf
CPA	Certified public accountant
CPI	Consumer Price Index
CRE	Component Reporting Entity
CSRS	Civil Service Retirement System

CRS	Congressional Research Service
D&D	decontamination and decommissioning
DHS	Department of Homeland Security
DI	Disability Insurance
DIS	Date-In-Service
DM-AI	Deferred Maintenance and Asset Impairment (task force)
DM&R	deferred maintenance and repairs
DOC	Department of Commerce
DoD	Department of Defense
DOL	U.S. Department of Labor
DOJ	Department of Justice
DOT	Department of Transportation
DSS	Defense Security Service
ED	exposure draft
EDP	electronic data processing
EO	Executive Order
EPA	Environmental Protection Agency
ESAA	Employment Security Administration Account
EUCA	Extended Unemployment Compensation Account
EUL	Enhanced Use Lease
FAA	Federal Aviation Administration
FAQ	Frequently Asked Question
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FBWT	Fund Balance with Treasury
FDIC	Federal Deposit Insurance Corporation
FECA	Federal Employees Compensation Account
FED LOG	Federal Logistics Data
FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement Plan
FFC	Federal Facilities Council
FFRDC	Federally Funded Research and Development Centers
FIFO	first-in, first-out
FMFIA	Federal Manager’s Financial Integrity Act
FR	Financial Report of the U.S. Government
FRPC	Federal Real Property Council
FRPP	Federal Real Property Profile
FRS	Federal Reserve System
FTCA	Federal Tort Claims Act
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act

FY	Fiscal Year
GAAP	generally accepted accounting principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
GASBS	Governmental Accounting Standards Board Statement
GDP	Gross Domestic Product
GIS	Geographic Information System
GLTDAG	General Long-Term Debt Account Group
GPFFR	general purpose federal financial report
GPFS	general-purpose financial statements
GPRA	Government Performance and Results Act
G-PP&E	General property, plant, and equipment
GRS	General Records Schedule
GSA	General Services Administration
GSE	government sponsored enterprises
HHS	Department of Health and Human Services
HI	Hospital Insurance (Medicare)
IBNR	incurred but not reported
IC	Intelligence Community
IG	Inspector General
IPA	Independent Public Accountant
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
IRR	Internal rate of return
IT	Information Technology
IUS	Internal Use Software
JFMIP	Joint Financial Management Improvement Program
KDP	Key Decision Point
LAC	latest acquisition cost
LCM	lower of cost or market
LIFO	last-in, first-out cost flow
LP	Limited Partnership
MA	Medicare Advantage
MD&A	management's discussion & analysis
M&R	maintenance and repairs
MRI	Magnetic resonance imaging
MRS	Military Retirement System
NAPA	National Academy of Public Administration
NARA	National Archives and Records Administration
NAS	National Airspace System
NASA	National Aeronautics and Space Administration

NCGAS	National Council on Government Accounting Statement
ND	National Defense
NFI	Non-financial Information
NIPA	national income and product accounts
NIST	National Institute of Standards and Technology
NSN	National Stock Number
NPR	National Performance Review
NPV	net present value
NRO	National Reconnaissance Office
O&M	operation and maintenance
OAI	other accompanying information
OASDI	Old-Age, Survivors, and Disability Insurance
OASI	Old-Age and Survivors Insurance
OCA	Original Classification Authority
OCS	Outer Continental Shelf
ODNI	Office of the Director of National Intelligence
OECD	Organisation for Economic Co-Operation and Development
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OM&S	Operating materials and supplies
ORB	other retirement benefits
ORFNI	Other Reported Financial and Non-Financial Information
OPEB	Other postemployment benefits
OSHA	Occupational Safety and Health Administration
P3	Public-Private Partnership
PB	President’s Budget
PBGC	Pension Benefit Guaranty Corporation
PBS	Public Buildings Service
PCB	Polychlorinated biphenyl
PERC	Perchloroethylene
PHYS/AIRSP	Physical Airspace
PP&E	property, plant, and equipment
PPP	Public-Private Partnership
PRP	potentially responsible parties
PRV	Plant replacement value
PSA	Personal Security Accounts
PSC	Public Sector Comparato
psf	Per square foot
PUC	projected unit credit
PV	present value
QA	Quality Assurance
RCRA	Resource Conservation and Recovery Act)

RE&D	Research, Engineering & Development
RFI	Request for Information
RFP	Request for Proposal
RI/FS	remedial investigation/feasibility study
RRB	Railroad Retirement Board
RSI	required supplementary information
RSSI	required supplementary stewardship information
SAS	Statement of Auditing Standards
SCA	Service Concession Arrangement
SCNP	Statement of Changes in Net Position
SCSIA	Statement of Changes in Social Insurance Amounts
SEC	Securities Exchange Commission
SETA	Systems Engineering and Technical Assistance
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SGL	Standard General Ledger
SL	Stewardship Land
SMI	Supplementary Medical Insurance (Medicare)
SNA	System of National Accounts
SNC	Statement of Net Cost
SOP	Statement of Position
SOSI	Statement of Social Insurance
SPV	Special Purpose Vehicle
SSA	Social Security Administration
TB	Technical Bulletin
TCTOs	Time Compliance and Technical orders
TR	Technical Release
TSCA	Toxic Substances Control Act
TSDF	Treatment Storage Disposal Facility
TSSC	Technical Support Services Contract
UI	Unemployment Insurance
U.S.	United States
USACE	U.S. Army Corp of Engineers
USBR	United States Bureau of Reclamation
USC	United States Code
USCG	U.S. Coast Guard
UTF	Unemployment Trust Fund
VA	Veterans Affairs
VFM	Value for Money